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No. 03-

IN THE

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually and on behalf of all others similarly situated,

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

Petition for a Writ of Certiorari to the Supreme Court of South Carolina

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether South Carolina's Act 189, one of numerous state statutes enacted to cure the unconstitutionality of the states' discriminatory taxation of federal employees' retiree benefits under *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989), is itself unconstitutional because the State simultaneously repealed the state retirees' tax exemption and increased state retirees' benefits for the purpose and with the effect of compensating state retirees for their increased tax obligations and thereby circumvented the requirement of equal treatment and perpetuated the discrimination found unlawful in *Davis*.

PARTIES TO THE PROCEEDING

All parties to the proceeding are identified in the caption.

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PETITION FOR CERTIORARI

Petitioners, Doris Steiglitz Ward individually and on behalf of all others similarly situated, respectfully petition for a writ of certiorari to review the judgment of the Supreme Court of South Carolina in this case.

OPINIONS BELOW

The opinion of the Supreme Court of South Carolina (App. 1a-8a) was entered on December 8, 2003, and is reported at 590 S.E.2d 30 (S.C. 2003). The order denying petitioners' cross-motion for partial summary judgment and granting the State's cross-motion for summary judgment (App. 10a-25a) was entered on August 26, 2002, and is not reported. The order denying the petitioners' motion to alter or amend (App. 9a) was entered on September 17, 2002, and is not reported.

JURISDICTION

The Supreme Court of South Carolina entered its decision and judgment on December 8, 2003. This Court has jurisdiction pursuant to 28 U.S.C. § 1257.

STATUTORY PROVISIONS INVOLVED

This case involves the application of the Public Salary Tax Act to South Carolina's Act 189.

The Public Salary Tax Act, 4 U.S.C. § 111(a), provides as follows:

> (a) General Rule. – The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a

> duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

The pertinent sections of Act 189, §§ 39, 60, 1989 S.C. Act 623, are set forth in App. 26a-33a.

INTRODUCTION

In *Davis* v. *Michigan Department of Taxation*, 489 U.S. 803, 817 (1989), this Court invalidated tax laws in nearly half the states because they discriminated against federal retirees by exempting state retirement benefits from taxation without providing a similar exemption for federal retirement benefits. The Court further held that "the appropriate remedy 'is a *mandate* of equal treatment,'" but left to the 23 affected States the question whether to accomplish that result "'by withdrawal of benefits from the favored class'" or "'by extension of benefits to the excluded class.'" *Id.* at 817-18. A number of these States decided to do neither, and instead to circumvent the mandate of equal treatment by simultaneously eliminating state retirees' exemptions and compensating those retirees for the new taxation.

Some state courts have held that the state legislatures' attempts to perpetuate this intergovernmental discrimination is unconstitutional; but others, including the South Carolina Supreme Court in the decision below, have approved these attempts to evade the anti-discrimination mandate that is embodied in the intergovernmental tax immunity doctrine. Relying (as it has before)[1] on the Tenth Amendment to

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[1] *See Jinks* v. *Richland County, S.C.*, 538 U.S. 456 (2003) (rejecting South Carolina Supreme Court's holding that federal tolling statute infringes upon the State's Tenth Amendment rights); *South Carolina* v. *Baker*, 485 U.S. 505 (1988) (rejecting South Carolina Supreme Court's holding that the Tax Equity and Fiscal Responsibility Act of 1982

support the State's claim to an unfettered right to determine state employee and retiree compensation, the South Carolina Supreme Court held that "the doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income." App. 3a. Thus, the court opined, "*any* restriction on th[e State's compensation] authority would violate the Tenth Amendment." *Id.* at 4a (emphasis supplied).

This petition, accordingly, arises from the conflict among state courts created by state legislatures' attempts to overhaul state taxation provisions that are unconstitutional under this Court's decision in *Davis*. The decision below broadens this conflict: two state courts have struck down statutes that the South Carolina court's test would have upheld; while another state court has, like South Carolina, permitted the state's evasive action. Yet another case is pending in Utah, and other similar statutes remain to be challenged.

It is not only this conflict which warrants the exercise of certiorari review. South Carolina's decision is also in significant tension with decisions of this Court. It is an illegitimate remedial response to the equal treatment mandate in *Davis*, because it seeks to continue rather than to cure discrimination. And, the decision cannot be squared with *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994), which held that a facially non-discriminatory tax is unconstitutional under the analogous jurisprudence of the dormant Commerce Clause if it is indisputably linked to a compensating subsidy.

Moreover, the question presented is both important and recurring. The intergovernmental tax immunity doctrine is one of the basic constitutional mechanisms that safeguards the balance of power between the federal and state governments.

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compels the State to issue bonds in registered form in violation of the Tenth Amendment).

See *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819); accord, *Jefferson County, Ala.* v. *Acker*, 527 U.S. 423, 436-37 (1999); *Harper* v. *Va. Dep't of Taxation*, 509 U.S. 86 (1993). South Carolina's application of that doctrine, if upheld, will eviscerate the protection provided by the doctrine, allowing its facile evasion so long as discriminatory taxation is labeled "compensation" or a "subsidy." Importing this rule into the closely analogous dormant Commerce Clause area would similarly erode that constitutional prohibition against discrimination.

In addition, this case has substantial practical implications for federal employees and retirees across the country. If states can so easily evade the mandate of *Davis* and the intergovernmental tax immunity doctrine, states may impose burdensome taxation on federal employees and retirees while protecting their own employees and retirees with compensatory increases, without incurring any political cost.

This petition will allow the Court to resolve the conflict among state courts about the constitutional requirement of equal treatment under the intergovernmental tax immunity doctrine, to foreclose the evasion of its mandate in *Davis*, to ensure the consistent development of its jurisprudence under the intergovernmental tax immunity doctrine and the dormant Commerce Clause, and to prevent discriminatory state taxation of federal employees and retirees now and in the future. For these reasons, this Court should grant certiorari.

STATEMENT OF THE CASE

1. In *Davis* v. *Michigan Department of Taxation*, 489 U.S. 803 (1989), a federal retiree challenged Michigan's taxation regime, which defined "taxable income" to include federal retirement benefits and exclude similar benefits received by former employees of the State or its political subdivisions. The Michigan Court of Appeals had held that the Public Salary Tax Act, 4 U.S.C. § 111, forbids discriminatory

taxation against federal "employees," but not against federal annuitants, including federal retirees. It also held that the intergovernmental tax immunity doctrine did not render Michigan's disparate tax treatment unconstitutional under a rational basis test, because the State had a legitimate interest in using favorable tax treatment to attract and retain qualified employees. The Supreme Court of Michigan denied the federal retiree's application for leave to appeal.

This Court reversed. First, it concluded that retirement benefits were deferred compensation for past years of service rendered to the federal government and therefore were covered by the Public Salary Tax Act. 489 U.S. at 808-09.

Second, the Court held that Congress codified the constitutional doctrine of intergovernmental tax immunity when it enacted § 111. *See id.* at 813. Section 111 specifies that the Government consents to state taxation of federal employees' compensation only "if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation," 4 U.S.C. § 111(a). See 489 U.S. at 812 (§ 111 "closely parallels the nondiscrimination component of the constitutional immunity doctrine which has, from the time of *McCulloch* v. *Maryland*, barred taxes that 'operat[e] so as to discriminate against the Government or those with whom it deals'") (alteration in original). Because the intergovernmental tax immunity doctrine shields current and former federal employees from discriminatory taxation, a state must justify disparate tax treatment on the basis of significant differences between classes of taxpayers. See *id.* at 816. Because Michigan was unable to justify its discriminatory taxation of federal retirement benefits, this Court concluded that the State had violated the principles of the intergovernmental tax immunity doctrine. *Id.* at 817.

The Court nonetheless declined to order a specific remedy for the discriminatory taxation. Instead, it held that "the appropriate remedy 'is a *mandate* of equal treatment, a result

that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class.'" *Id.* at 817-18 (quoting *Heckler* v. *Mathews*, 465 U.S. 728, 740 (1984)). This Court allowed the states to decide which of these alternative remedies they would adopt to eliminate discrimination in their taxation schemes.

2. When *Davis* was decided, the tax codes of 23 states discriminated in some manner against federal retirees. *Harper*, 509 U.S. at 93 & n.5 (citing state codes); see also *Harper* v. *Va. Dep't of Taxation*, 401 S.E.2d 868, 871 n.2 (Va.) (citing all 23 state codes), *vacated on other grounds*, 501 U.S. 1247 (1991). Many states responded to this Court's mandate of equal treatment by extending to federal retirees the same tax exemptions available to state retirees.[2] Other states chose to withdraw the exemptions that favored state retirees, bearing the political consequences of that decision.[3]

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[2] *See* Ark. Code Ann. § 26-51-307 (exempting first $6000 of all retirement income); Colo. Rev. Stat. Ann. § 39-22-104(4)(f) (exempting all pensions); Kan. Stat. Ann. § 79-32,117(c)(vii) (exempting federal benefits from taxation); Ky. Rev. Stat. Ann. § 141.021 (exempting all federal retirement benefits from taxation); 1989 La. Acts 812, § 1 (amending La. Rev. Stat. Ann. § 47:44.2 to exempt all federal retirement pay from state taxation); *Fonger* v. *Dep't of Treasury*, 483 N.W.2d 920, 921-22 (Mich. Ct. App. 1992) (per curiam) (describing enactment extending exemption to federal retirees); 1993 Miss. Laws ch. 523, § 1 (amending Miss. Code Ann. § 27-7-15(4)(k) to exempt federal benefits from taxation); Mo. Rev. Stat. § 143.124 (providing tax exemption for first $6000 of retirement income for state and federal retirees); 1989 N.Y. Laws ch. 664, § 1 (amending N.Y. Tax Law § 612(c)(3) to exempt federal pensions from state taxation); *Brown* v. *Mierke*, 443 S.E.2d 462 (W. Va. 1994) (describing West Virginia's response to *Davis*); *Hogan* v. *Musolf*, 471 N.W.2d 216, 218-19 (Wis. 1991) (noting passage of statute extending tax exemption to federal retirement income). Iowa took a middle course, eliminating the tax exemption for state retirement benefits and replacing it with a partial tax exemption for both federal and state benefits. *See* 1989 Iowa Acts ch. 228, §§ 1, 2, 8.

[3] *See* Ga. Code Ann. § 48-7-27(a)(4), (5) (replacing total exemption for state benefits with a partial exemption equivalent to the partial exemption

A third group of states, however, manipulated their taxation and benefits regimes to test *Davis*' mandate of non-discrimination – *viz.*, they withdrew the discriminatory exemption in favor of former state employees while simultaneously compensating those retirees for the loss of their favored tax status vis-à-vis federal retirees. For example, Montana responded to *Davis* by subjecting all retirement income (including state pensions) to state income tax and offsetting that tax by increasing retirement pay to state retirees who were Montana residents. See *Sheehy* v. *Pub. Employees Ret. Div.*, 864 P.2d 762, 764 (Mont. 1993). With limited variations, several others states similarly eliminated a tax exemption for state retirement benefits with one hand, while restoring retirement benefits with the other.[4]

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available to federal retirees); 1990 N.M. Laws ch. 49 (repealing tax exemptions for state retirement benefits), *cited in Pierce* v. *State*, 910 P.2d 288, 292 (N.M. 1995); *Strelecki* v. *Okla. Tax Comm'n*, 872 P.2d 910, 911 n.4 (Okla. 1993) (discussing elimination of total exemption for state retirement benefits and new partial exemption that had applied to federal retirement benefits); *see also Parrish* v. *Employees' Ret. Sys.*, 398 S.E.2d 353, 353-54 (Ga. 1990) (describing Georgia's legislative response to *Davis*).

[4] *See McClead* v. *Pima County*, 849 P.2d 1378, 1381 n.2 (Az. Ct. App. 1992) (characterizing 1989 Ariz. Sess. Laws ch. 310 as "a permanent increase in base benefits known as a 'tax equity benefit allowance'"); 1989 N.C. Sess. Law ch. 792 (eliminating tax exemption for state and local government retirees and providing for adjustment payments then and in the future); 1991 Or. Laws ch. 823, §§ 1, 3 (amending Or. Rev. Stat. § 237.201 to repeal tax exemption for state retirement benefits), *cited in Vogl* v. *Dep't of Revenue*, 960 P.2d 373, 375-77 (Or. 1998); Utah Code Ann. § 49-11-701; 1989 Va. Acts Spec. Sess. II, ch. 3 (repealing exemption for state benefits), *cited in Almeter* v. *Va. Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589, at *1 (Va. Cir. Ct. Nov. 6, 2000); 1990 Va. Acts chs. 507, 525 (increasing state pension benefits to offset the new tax); *Ragsdale* v. *Dep't of Revenue*, 895 P.2d 1348, 1350 (Or. 1995) (en banc) (same); *Thompson* v. *Utah State Tax Comm'n*, No. 20030506-SC (Utah, filed June 13, 2003) (challenging the Utah tax scheme in the state supreme court).

3. South Carolina is among those states that purported to eliminate its retirees' facial tax exemption while maintaining the disparate treatment of state and federal retirees by compensating state retirees for the loss of that favored treatment. Prior to *Davis*, South Carolina exempted all state retirement benefits from taxation, but only the first $3000 of federal retirement benefits. In response to *Davis*, the South Carolina General Assembly passed Act 189, which repealed the tax exemption for state retirement benefits, thereby rendering both state and federal retirement benefits in excess of $3000 subject to taxation. Act 189, § 39, 1989 S.C. Acts 623 ("Act 189"). That same act, however, simultaneously increased benefits for state retirees by seven percent, *id.* § 60, which was and remains today the highest marginal tax rate in South Carolina, see S.C. Code Ann. § 12-7-210 (1976); *id.* § 12-6-510(A) (2000).

4. In 1998, petitioners commenced a class action alleging that Act 189 was unconstitutional and seeking an injunction against future taxation and damages for past paid taxes. See *Ward* v. *South Carolina*, 538 S.E.2d 245, 246 (S.C. 2000). After an initial ruling, appeal and remand concerning state jurisdictional issues, the circuit court upheld Act 189. See App. 1a.

The Supreme Court of South Carolina affirmed. App. 8a. In reaching its decision, the court recognized that *Davis* mandated equal tax treatment of federal and state retirees' benefits. The court, however, rejected petitioners' claim that South Carolina's seven percent increase in retirement benefits had recast the pre-*Davis* discriminatory tax exemption as a discriminatory tax rebate. See *id.* at 3a.

The court expressed the view that the South Carolina General Assembly had complied with the mandate of *Davis* by eliminating the exemption that advantaged state retirees. App. 3a-4a. In reaching this conclusion, the court observed that "[t]he State does not dispute that the General Assembly increased retirement benefits to compensate state retirees, in

part, for their increased income tax obligations resulting from the enactment of Act 189," *id.* at 3a, but nonetheless rejected petitioners' argument that the "indisputable linkage" between Act 189's repeal of the tax exemption and its simultaneous increase in state retirement benefits rendered the scheme as a whole impermissibly discriminatory. *Id.* at 4a. Relying on the Tenth Amendment, the court explained that neither *Davis* nor the intergovernmental tax immunity doctrine precluded the State from raising retirement benefits even if the raise "serves to offset a prior tax exemption." *Id.* Put differently, the court believed that *Davis* was concerned only with *taxation*, and that state retiree *compensation* decisions were beyond its review. *Id.* at 5a ("*Davis* requires that the state *tax* federal and state retirees equally and does not concern itself with the manner in which a state chooses to *compensate* its retirees.").

In so concluding, the court emphasized that although the elimination of the exemption and the increase in compensation were simultaneous and although the State acknowledged its purpose to preserve the favored treatment of its own retirees, the computational correlation between the state retirees' new tax obligations after Act 189 and the seven percent increase in their benefits was not absolutely precise. App. 6a. On this basis, the court also sought to distinguish the Oregon Supreme Court's decision in *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998) – holding unconstitutional an Oregon statute compensating state retirees for the loss of their favored status – because the offsetting compensation provided by the Oregon statute was "mathematically correlated to replace the [state retirees'] lost state retirement income." App. 7a. The South Carolina court then attempted to distinguish a decision of the Montana Supreme Court – also holding unconstitutional an act that combined the repeal of a state retiree exemption and a state retiree benefit increase – on the ground that the Montana act applied only to

state retirees who were also state residents. See *id.* (discussing *Sheehy* 864 P.2d at 764, 768).

Moreover, the South Carolina court opined that its decision upholding Act 189 was consistent with an Oregon decision upholding a 1991 statute (enacted before Oregon's 1995 statute that was invalidated in *Vogl*) and with a Virginia decision upholding that state's statutory response to *Davis*. See App. 8a & n.2 (discussing *Ragsdale* v. *Dep't of Revenue*, 895 P.2d 1348 (Or. 1995) and *Almeter* v. *Va. Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589 (Va. Cir. Ct. Nov. 6, 2000)).

REASONS FOR GRANTING THE PETITION

I. THE SOUTH CAROLINA COURT'S DECISION BROADENS THE CONFLICT AMONG STATE COURTS ABOUT APPLYING THE INTER-GOVERNMENTAL TAX IMMUNITY DOCTRINE UNDER *DAVIS*.

The decision below broadens an extant conflict among state supreme courts assessing the constitutionality of the remedies that state legislatures have enacted to cure the unconstitutional discrimination against federal employees identified in *Davis*. Specifically, the courts are in conflict about whether increases in state employees' compensation – even increases passed simultaneously with legislation eliminating discriminatory tax treatment and for the purpose of perpetuating the state employees' favored treatment – are unconstitutional. The courts are also divided, or at the very least deeply confused, about the showing that is required to demonstrate that increased compensation is in fact an unconstitutional tax rebate.

To date, two state supreme courts have struck down state laws that repeal a discriminatory tax exemption for state retirement benefits while simultaneously increasing the benefits paid to state retirees, holding that the laws constitute

a discriminatory tax rebate that violates the intergovernmental tax immunity doctrine set forth in *Davis*. See *Sheehy*, 864 P.2d at 768; *Vogl*, 960 P.2d at 379. These courts recognize that a state statute facially directed to the compensation of state employees may, in fact, be an unconstitutional tax rebate if the relevant evidence shows that the law is intended to perpetuate, and actually does perpetuate, discrimination against federal employees.

The Montana Supreme Court's decision in *Sheehy* addresses Montana's 1991 act, repealing its total tax exemption for state retirement income and replacing it with an exemption for the first $3600 of all pension and annuity income, phased out for higher income levels. 864 P.2d at 764. In the very same enactment, however, the Montana legislature also granted an annual retirement adjustment payment to all state retirees who were Montana residents and whose benefits were newly-subject to taxation because of *Davis*. *Id.* The Montana Supreme Court struck down the 1991 act, holding that the repeal of the tax exemption and the increase in retirement benefits were linked. *Id.* at 768 ("[t]he State's argument that the two portions of the bill are not related defies logic"). The court found the legislature's purpose entirely clear:

> [T]he relationship between the tax equalization provisions of the bill, with their negative impacts on state retirees, and the adjustment intended to make up, in part, for that equalization cannot be gainsaid. The adjustment – while purporting to be an adjustment to state retirement benefits – is in fact, an adjustment to the equalization achieved via the first sections of [the act]. This conclusion is inescapable given the inclusion of the adjustment in, and as part of, the tax equalization program. [*Id.* at 768.]

The court found additional evidence of the legislature's illegitimate purpose in the State's restriction of the adjustment to those living within the State and in the State's funding of

the benefit not from state retirement plan assets but from the State's general revenues. *Id.* From all of the above, the court concluded that "the adjustment is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law," *id.*, and thus violates the Constitution.

The Oregon Supreme Court, too, has found unconstitutional an Oregon law simultaneously repealing a state retiree tax exemption and enacting a state retiree benefit increase. Prior to 1991, retirement benefits paid to Oregon public employees were exempt from all state taxes, but there was no similar exemption for federal retirement benefits. *Vogl*, 960 P.2d at 375. In 1991, the Oregon legislature enacted a response to *Davis*; the Oregon Supreme Court, sitting *en banc*, narrowly upheld the 1991 law over the dissent of Justice Gillette who characterized the 1991 act as "a legislative device specifically and narrowly tailored to avoid the rule of intergovernmental tax immunity that was explicated by the Supreme Court of the United States in *Davis*." *Ragsdale*, 895 P.2d at 1357 (Gillette, J., dissenting).[5]

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[5] Specifically, in 1991, in response to *Davis*, Oregon's legislature repealed the tax exemption for state retirees and increased the retirement benefits payable to state retirees who became subject to the new tax. *Ragsdale*, 895 P.2d at 1350. Additionally, the legislature provided that the increased benefits were to cease if state retirement benefits were exempted from Oregon's personal income taxation. *Id.* at 1351. The Oregon Supreme Court upheld the law, holding that the federal retiree's claim could succeed only if the increased retirement benefits paid to state retirees were tax rebates. The court found evidence pointing both ways: The State's concession that the 1991 benefit increase was intended to compensate state retirees for the increased tax liabilities, *id.* at 1352, and the termination of the increased retirement pay if state benefits became tax exempt both "point[ed] toward a tax rebate." *Id.* at 1354. On the other hand, the court found that *Davis* was concerned with taxation and not with the compensation a state paid its retirees and that, considering only taxation, the State had adopted one of the *Davis* Court's suggested remedies. *Id.* In addition, the court found that the new benefits were not limited to state residents, were not correlated with the amount of the

In 1995, however, Oregon amended its tax and benefits scheme for a second time, enacting an increased retirement benefit for any year in which state retirement benefits were not exempt from state personal income taxation. See *Vogl*, 960 P.2d at 376. This increase was tied to Oregon's income tax rate and applied only to the retirement benefits attributable to the period before the 1991 repeal of the state tax exemption. See *id.* at 376-77. This time, in an opinion authored by former dissenter Justice Gillette, the Oregon Supreme Court found that the tax and benefit scheme was an unconstitutional tax rebate under *Davis*. *Id.* at 379-80.

The *Vogl* court first explained that a benefits increase can be linked to the repeal of a discriminatory tax exemption in such a way that it amounts to a tax rebate that perpetuates the discriminatory taxation. Indeed, *Vogl* took this to be "one obvious point" in *Ragsdale*; "*Ragsdale* clearly endorses the notion that, just as a tax *exemption* that discriminates against federal retirees would violate the doctrine of intergovernmental tax immunity, so would a tax *rebate* that discriminates against federal retirees." *Id.* at 379 (citing *Ragsdale*, 895 P.2d at 1356). Thus, *Vogl* held that "in the world of intergovernmental tax immunity, substance does count." *Id.*

With respect to the 1995 Oregon law, the court observed that the State did the best it could to make the increase in benefits "approximate the amount needed to offset the effect of [the] 1991 repeal," *id.* at 380, but that "as with the 1991 increase, entitlement to the 1995 increase is not conditioned on *actual* liability for an equivalent amount in state taxes" and that state retirees receive the increase "even if they pay little

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increased tax liabilities following repeal of the exemption, and were not paid out of the general fund. *Id.* at 1354-56. On balance, the court rejected the idea that the increased benefits amounted to a tax rebate in violation of the intergovernmental immunity doctrine. *Id.* at 1357. As noted in text, Justice Gillette, the author of *Vogl*, dissented.

or no state income tax on their . . . benefits." *Id.* Thus, the court concluded:

> The upshot of the foregoing discussion is that, although the 1995 statute is similar to its 1991 predecessor in that it does not purport to offset, dollar for dollar, the amount lost to the exemption repeal in every individual case, its design and effect far more closely match such a purpose. Clearly, as the state moves closer to replacing the lost net income on a dollar-for-dollar basis, the fact that the increase is in fact a tax *rebate*, rather than a general increase in compensation to "make up" for lost net income becomes more apparent. That is particularly so in view of the fact that the increase is available *only in those years when [retirement] benefits are not tax exempt*. [*Id.* (emphasis in original).]

In addition, the Oregon court relied on the 1995 statute's express announcement that the increases were paid "'in compensation for damages suffered by members of [the retirement plan] . . . by reason of subjecting [retirement] benefits . . . to Oregon personal income taxation.'" *Id.* (omissions in original) (quoting 1995 Or. Laws, ch. 569, § 2(1)). The court explained that "[t]he state cannot have it both ways. It cannot claim that, for one purpose, the increase is legal compensation, *i.e.* damages, while, for other purposes, it is 'merely' a retirement 'benefit.'" *Id.* Thus, the court concluded: "The [benefits] increase purports to give [state] retirees what they were promised, *viz.*, tax-free retirement benefits. Because the retirees *were taxed*, the increase is the cure. And a cure for being overtaxed is a *rebate*." *Id.* at 380-81. Thus, "[t]aken collectively, the foregoing aspects of the 1995 statute satisf[ied] th[e] court that the benefit increase provided therein is, in substance, a tax rebate" and therefore unconstitutional. *Id.* at 381.

The South Carolina court's opinion in *Ward* directly conflicts with the analysis and the holdings of *Sheehy* and *Vogl*. *Ward* expressly states that an increase in retirement

benefits (or any other state compensation) can *never* be characterized as an unconstitutional tax rebate that violates the intergovernmental tax immunity doctrine. Relying on the Tenth Amendment, the *Ward* Court announced that a state's determination of state employees' compensation is *immune* from constitutional evaluation under the intergovernmental tax immunity doctrine:

> [T]he doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income. . . . The power to compensate state retirees is clearly not delegated to the United States by the Constitution. As long as federal and state retirees are taxed equally, any restriction on this [compensation] authority would violate the Tenth Amendment. [App. 3a-4a.]

And, *Ward* expressly holds that South Carolina is not "prohibited from adjusting the compensation of its employees, *even if the state's purpose is to compensate its employees for the loss of the income tax exemption*." App. 5a (emphasis supplied).

The *Ward* court's analysis is virtually identical to that of the Virginia court which upheld a state statute eliminating state retirees' income tax exemption, while increasing retirement benefits by three percent and making a lump sum payment of $15.75 million to state retirees. See *Almeter* v. *Va. Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589, at *2 (Va. Cir. Ct. Nov. 6, 2000). Indeed, the *Almeter* court stated that "[b]ecause the actions complained about by plaintiffs, even if true, are the types of actions specifically contemplated and condoned by the Supreme Court of the United States in *Davis*, the plaintiffs have failed to state a cause of action." *Id.* *Almeter* thus read this Court's decision in *Davis* expressly to authorize states "to pay extra money to

state retirees to make up for what those retirees lost as a result of being taxed." *Id.*

Had the Montana and Oregon Supreme Courts accepted the analysis of *Ward* and *Almeter*, they would have upheld the Montana and Oregon taxation and benefit schemes that they struck down as unconstitutional. Under *Ward* and *Almeter*, the Montana and Oregon legislatures were simply exercising their unfettered, constitutionally-protected authority to determine state employee compensation. Indeed, according to *Ward* and *Almeter*, there is no constitutional problem under *Davis* and the intergovernmental tax immunity doctrine, even if the linkage between the repealed tax exemption and the increased state retirement benefits indisputably demonstrates that the scheme is in effect a tax rebate that preserves discriminatory tax treatment. See App. 4a; *supra* at 15. There is, accordingly, a square and fundamental conflict between *Ward* and *Almeter*, on the one hand, and *Sheehy* and *Vogl*, on the other.

There is a significant corollary confusion among the state courts that have addressed whether the states' statutory responses to *Davis* are constitutional. There is no settled test for determining whether compensation increases are constructive tax rebates. In analyzing this question, state courts have considered the legislatures' articulated purpose, the simultaneity of the tax exemption repeal and the compensation increase, and the correlation between the coverage and the costs imposed by the repeal and the coverage and the amount of compensation provided by the benefit increase. But, the courts are wholly confused about how much linkage between tax exemption repeals and increased benefits warrants characterization of a benefit increase as a tax rebate.

This confusion is clearly evinced in the outcomes in the state Supreme Courts on the issue. There are substantial, critical similarities among all the state schemes at issue in *Ward*, *Almeter*, *Sheehy*, *Ragsdale*, and *Vogl* and only minor

differences among them. Yet, the courts reached conflicting conclusions by attaching varying degrees of importance to different factors. See Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167, 2179-81 (1997) (discussing the conflict between *Sheehy* and *Ragsdale*). In *Sheehy* and *Vogl*, for example, each court appeared to find the combined effect of the state's evident purpose and the rough correlation between the increased tax burden and the benefit increases sufficient evidence of linkage to render the legislation a tax rebate, at least where the state is crafting a remedy for a past constitutional violation. In *Ward*, *Almeter*, and *Ragsdale*, similar demonstrations were deemed either irrelevant (in the first two cases) or inadequate (in the third).

In *Ward*, South Carolina did not dispute that the General Assembly increased the state retirees' benefits to offset their increased tax obligations resulting from Act 189's repeal of the tax exemption. See App. 3a; see also *Ward*, 538 S.E.2d at 246 n.4 ("[s]ections 39 and 60 link the increase in state retirement benefits to the elimination of the tax exemption for state retirees' benefits"); *Evans* v. *South Carolina*, 543 S.E.2d 547, 549 (S.C. 2001) ("the General Assembly increased the pension benefits for state retirees by 7% to offset the increased tax liability resulting from the lost exemption"). And, although the court found that the benefit increase did not provide dollar-for-dollar compensation for the increased tax burden, the record demonstrated that the correlation was very high. See, *e.g.*, 1989 Report of the South Carolina Retirement System (discussing *Davis* and Act 189, stating "our retirement benefits formulas were enhanced so as to not penalize retirees as a result of this legislation"), *reproduced as* Compl. Exh. B, Record on Appeal at 75, *Ward* v. *South Carolina*, 590 S.E.2d 30 (S.C. filed May 13, 2003); Rainwater Dep. Exh. A (a calculation demonstrating how to increase benefits to offset the new taxes imposed on state

retirees), *reproduced as* Exh. C to Mot. for Summ. J., Record on Appeal at 91, *Ward* v. *South Carolina*, 590 S.E.2d 30 (S.C. filed May 13, 2003). In other words, had the *Ward* court given effect to this linkage, as the *Sheehy* and *Vogl* courts did, it would have found that Act 189 enacted an unconstitutional tax rebate.

This Court should grant the petition to resolve the conflict among state courts on the question whether state statutes increasing state employee compensation can constitute constructive tax rebates in violation of the intergovernmental tax immunity doctrine or whether states have unreviewable power to perpetuate discrimination by substituting compensation for a prior tax exemption. The Court should simultaneously clarify the standard for determining when the linkage between the repeal of a tax exemption and an increase in compensation demonstrates that the latter is an unconstitutional tax rebate.

II. THE SOUTH CAROLINA COURT'S OPINION IS IN SUBSTANTIAL TENSION WITH THIS COURT'S PRECEDENTS.

The decision below is in substantial tension with *Davis* and with this Court's dormant Commerce Clause jurisprudence embodied in *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994). By approving Act 189, the South Carolina Supreme Court permitted the circumvention of *Davis*' directive that the states accord federal retirees equal tax treatment. In addition, the court's rejection of petitioners' "indisputable linkage" argument cannot be reconciled with *West Lynn Creamery* which, in the analogous dormant Commerce Clause context, requires courts evaluating state taxation of commerce to make a substantive inquiry into the discriminatory effect not only of taxation, but of linked tax rebates or subsidies.

(A) *Ward* manifestly conflicts with this Court's directive in *Davis* that states end their discriminatory taxation of federal

retirees. Whatever freedom to act a state possesses *before* this Court determines that one of its statutes is unconstitutional, once this Court has done so, the affected state is obliged to enact a *remedy* curing the unconstitutionality of the prior statute. Here, the affected states may not avoid their remedial obligation to afford state and federal retirees equal treatment by manipulating the state compensation and taxation schemes to provide flatly unequal treatment.

Although *Davis* presented the states with a choice between alternative remedies, the choice was a hard one. States were required either to extend state retirees' exemptions to federal retirees and give up the revenues realized from taxes on federal retirement benefits, or to eliminate the tax exemption for state retirees and accept the political consequences of that act. See *Reynoldsville Casket Co.* v. *Hyde*, 514 U.S. 749, 755 (1995) (*Davis* requires the states to cure their differential treatment of federal and state retirement benefits "either by similarly burdening, or by similarly unburdening, both groups"). Neither choice is politically attractive. State legislatures are loath to extend the availability of tax exemptions, particularly if that act results in a need for across-the-board tax increases. States legislatures are also unwilling to raise the tax burden of state employees and retirees who frequently constitute a powerful bloc of voters.

South Carolina and other states chose to avoid making this hard political decision. Instead, they simultaneously eliminated the tax exemption for state retirement benefits and increased the benefits paid to state retirees. These states thus preserved the stream of tax revenues from federal retirees without raising taxes and placated state retirees who lost their tax exemption by increasing their benefits in an amount that roughly corresponded to the increased tax burden. Put differently, South Carolina and others enacted a combination of new taxes and new benefit payments in order to keep the

state treasury and state retirees in practically the same financial position they occupied before *Davis*.

Particularly where, as here, the affected states are in the procedural posture of remedying an established constitutional violation, there are two reasons that the federal courts must not allow the states to evade the hard choice posed by *Davis* in this manner.

First, the political process will not protect the remedial mandate of equal treatment for state and federal retirees. Federal retirees are not a substantial bloc of voters; state retirees and employees are certain to exert political pressure to maintain their favorable treatment; and the greater body of voters is uninterested in giving federal employees a tax break that might increase taxes overall. Cf. *W. Lynn Creamery*, 512 U.S. at 200 ("[W]hen a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy."). South Carolina's failure to provide an appropriate remedy, though understandable, nonetheless violates *Davis*, and federal retirees must look to the courts rather than the political process for enforcement of their right to equal treatment.

Second, South Carolina's facile evasion of the alternative *Davis* remedies threatens the institutional integrity of the Court. This Court has found a constitutional violation and issued a remedial mandate requiring equal treatment. In most situations, a state's decision to increase its employees' and retirees' benefits is none of the Court's concern. Here, however, the State's decision to increase retiree benefits is for the purpose of circumventing this Court's mandate to end discrimination and provide equal treatment.

The decision below entirely fails to take into account that a constitutional remedy should "restore the victims of

discriminatory conduct to the position they would have occupied in the absence of such conduct." *Milliken* v. *Bradley*, 433 U.S. 267, 280 (1977) (internal quotation marks omitted) (quoting *Milliken* v. *Bradley*, 418 U.S. 717, 746 (1974)); *United States* v. *Virginia*, 518 U.S. 515, 547 (1996) (the objective is to "eliminate [so far as possible] the discriminatory effects of the past and to bar like discrimination in the future") (internal quotation marks omitted, alteration in original) (quoting *Louisiana* v. *United States*, 380 U.S. 145, 154 (1965)). In states like South Carolina, where legislatures have eliminated discriminatory tax exemptions but also have offset the new taxes, federal retirees manifestly were not placed in the position they would have occupied absent the original discrimination. These states have not cured but have instead perpetuated their schemes of discriminatory taxation. No court would permit a state similarly to evade enactment of an effective remedy for, *e.g.*, unlawful race or gender discrimination. Cf. *Green* v. *County Sch. Bd.*, 391 U.S. 430, 439-41 (1968) (rejecting freedom-of-choice plan as a remedy for unconstitutional school segregation); *Wright* v. *Council of Emporia*, 407 U.S. 451 (1972) (enjoining local officials from carving out new school districts to prevent school integration).

Indeed, according to *Ward* and *Almeter*, the sole consequence of the Court's decision in *Davis* is that the state must employ some fiscal tool other than a tax exemption to put the monetary benefit of the tax exemption in the state retirees' pocket. If this is true, then the intergovernmental tax immunity doctrine is little more than a rule of procedure, and certainly not a substantive protection for federal employees. Of course, it is not true; and for this reason, too, the South Carolina Supreme Court's decision is in significant tension with *Davis*.

(B) *Ward*'s holding that it is *irrelevant* whether there is a link between South Carolina's simultaneous increase in benefits and repeal of a discriminatory tax exemption cannot

be reconciled with the analysis in *West Lynn Creamery*. That case involved a Massachusetts program that assessed a premium payment on out-of-state and in-state producers of fluid milk selling their product to Massachusetts retailers. Roughly two-thirds of the milk producers were from out of state, but the aggregate assessment was distributed in its entirety to Massachusetts dairy farmers. See 512 U.S. at 188.

Although the assessment was levied on in-state and out-of-state producers, the Court found the assessment discriminatory because it was offset by a subsidy paid solely to in-state dairy farmers from the assessed funds. *Id.* at 194; see *id.* ("[l]ike an ordinary tariff, the tax is thus effectively imposed only on out-of-state products"). Massachusetts defended its program by arguing that each element – the nondiscriminatory tax and the separate subsidy to in-state dairy farmers – was constitutional, so the whole program must be constitutional. This Court first noted the "err[or] in assuming that the constitutionality of the pricing order follows logically from the constitutionality of its component parts." *Id.* at 199. Critically here, the Court rejected the State's argument, because it "would require us to analyze separately two parts of an integrated regulation, but we cannot divorce the premium payments from the use to which the payments are put." *Id.* at 201.

Thus, in its dormant Commerce Clause jurisprudence, this Court has held that where taxes and subsidies are linked, a subsidy can convert a facially nondiscriminatory tax into an unconstitutionally discriminatory one. And, relevant here, the Court has made clear that dormant Commerce Clause cases are "conceptually similar [to the] field of intergovernmental taxation, where nondiscrimination also plays a central role in setting the boundary between the permissible and the impermissible." *Id.* at 200 n.17. See also Coenen & Hellerstein, *supra*, at 2168 ("[i]n each of these settings, the essential problem is the same: whether courts should view the state taxing and spending measures as an integrated whole or

as independent components of the law for purposes of constitutional analysis"); *Acker*, 527 U.S. at 439 (noting that "[t]he practical impact, not the State's name tag," determines whether something fits within the Public Salary Tax Act); *Kerr* v. *Killian*, No. CV-03-0110-PR, 2004 WL 258200, at *8 (Az. Feb. 13, 2004) (en banc) (explaining that it was required to examine the Arizona tax scheme's "practical operation" and that "[i]f the inevitable consequence of a facially neutral state tax code were that federal employees were taxed differently than similarly situated state employees because of the source of their income, or if the distinctions drawn in the state code were 'only a cloak for discrimination against federally funded [pay or compensation],' [4 U.S.C. §] 111(a) would plainly invalidate such a scheme.") (first alteration in original) (quoting *Barker* v. *Kansas*, 503 U.S. 594, 604-05 (1992)).

Ward cannot be harmonized with the analysis of *West Lynn Creamery*. Indeed, *Ward* held as a matter of law that courts assessing remedies for discriminatory taxation may not even consider whether a compensation increase is "indisputabl[y] link[ed]" to the demise of a tax exemption. See App. 4a. In light of the close analogy between this Court's dormant Commerce Clause and intergovernmental tax immunity doctrines, we submit that the decisions are in conflict; clearly, the decisions cannot be coherently reconciled.

The decision below is in substantial tension with both *Davis* and *West Lynn Creamery*; and this Court should grant the petition to resolve that tension, as well as the conflict among the lower courts.

III. THE CASE PRESENTS AN IMPORTANT AND RECURRING QUESTION OF FEDERAL LAW.

The petition is also worthy of the Court's attention because it presents an important and recurring question of federal law with respect to the intergovernmental tax immunity doctrine

that also has significant implications for cases arising under the dormant Commerce Clause.

The intergovernmental tax immunity doctrine plays an important role in the preservation of the Constitution's balance of power between the federal and state sovereigns. Because "the power to tax involves the power to destroy," *McCulloch*, 17 U.S. (4 Wheat.) at 429, an enlargement of the state's taxation powers at the expense of the federal government raises important constitutional concerns, *Davis*, 489 U.S. at 809. This case, moreover, presents an intergovernmental tax immunity question of unique importance for several reasons.

First, *Ward* squarely presents the question whether states may circumvent the remedial mandate of equal treatment by eliminating a tax exemption and simultaneously providing compensation for the increased tax burden. The *Ward* court held that states may always do so, and that the federal courts have no power to review state compensation decisions for unconstitutionality under the intergovernmental tax immunity doctrine. If this holding is correct, the doctrine has lost much of its importance. Moreover, if the holding is transferred to the analogous dormant Commerce Clause arena, the states have a new and enhanced power to subsidize their own citizens and industries, even if their taxation schemes are manifestly discriminatory. See Coenen & Hellerstein, *supra*, at 2172-73. If these important constitutional doctrines are to be rendered ineffectual in this manner, a counter-intuitive proposition, then the decision should be made by this Court.

Second, *Ward* directly raises the specific question whether the states may lawfully respond to this Court's decision in *Davis* by using fiscal tools other than taxation to maintain state retirees' favored position. *Davis* was an important case to tens of thousands of federal retirees; it promised federal retirees in 23 states that they would somehow receive equal treatment and many retirees have seen the mandate of equal treatment fulfilled. In the states that have sought to preserve

state retirees' favored status, however, the state courts are divided on the question of what constitutes equal treatment for state and federal retirees. That division has meant that federal retirees have received fundamentally different remedies in states that have enacted substantially similar remedial responses to *Davis*. This lack of uniformity in the remedial response to *Davis* is profoundly unfair to federal retirees. Indeed, as set forth above, it is important that this Court both resolve the conflict about the remedies for the constitutional violation in *Davis* and make clear that its remedial mandate cannot be so easily evaded.

A third and related point is that the issue presented in this case – the constitutional significance of retirement benefits increases that are linked to repeals of discriminatory tax exemptions – is one that is likely to recur. The issue was presented in all the cases described *supra*; in addition, a materially identical case is currently pending before the Utah Supreme Court. See *Thompson* v. *Utah State Tax Comm'n*, No. 20030506-SC (Utah filed June 13, 2003). If *Ward* and *Almeter* are permitted to stand, other states will be encouraged to follow their lead and enact linked repeals of tax exemptions and compensation increases for state employees.

Finally, this Court is the sole federal forum with jurisdiction to resolve the important constitutional issue posed by the petition and to end the conflicting approaches taken by the state courts. The Anti-Tax Injunction Act, 28 U.S.C. § 1341, precludes federal retirees like Ward from seeking prospective relief against such tax regimes. In addition, the Eleventh Amendment and this Court's prudential decisions, see, *e.g.*, *Fair Assessment in Real Estate Ass'n, Inc.* v. *McNary*, 454 U.S. 100, 116 (1981), make other federal courts unavailable to federal retirees challenging discrimination in state taxation. This Court is uniquely situated to address and resolve the important and recurring legal issue presented here.

IV. THE SOUTH CAROLINA COURT'S DECISION WAS WRONG.

The principal holding of *Ward* is that courts lack the power to review a state legislature's decision to increase state employees' compensation or state retirees' retirement benefits. This is wrong for numerous reasons.

First, in this case, the South Carolina legislature was acting against the backdrop of this Court's decision in *Davis*. In that case, the Court found a constitutional violation and ordered the states to remedy that violation by eliminating discrimination and providing equal treatment. In this setting, the states were not free to employ an alternative fiscal tool to perpetuate the extant discrimination. And, the federal remedial mandate barring such action clearly does not violate the Tenth Amendment.

In any event, this Court requires that the constitutionality of any taxation measure be assessed according to its practical impact or effect. See *Acker*, 527 U.S. at 439 (emphasizing that "[t]he practical impact, not the State's name tag," controls); *W. Lynn Creamery*, 512 U.S. at 194-95 & n.10 (citing the actual results of the Massachusetts program). *West Lynn Creamery* also teaches that the constitutional inquiry is not limited to the taxation component of an enactment; the effects of an integrated legislative program must be jointly considered. *Id.* at 201 (refusing to "analyze separately two parts of an integrated regulation"). Thus, where a taxation measure is linked with a subsidy measure in such a way that the two comprise an "integrated regulation," the effects of the enactments must be jointly evaluated.

There is no doubt that South Carolina's repeal of its discriminatory tax exemption is linked with its increase in state retirement benefits such that the effects of the two measures must be considered together. Indeed, South Carolina acknowledged that the provisions were linked, as did the South Carolina Supreme Court on several occasions. See

supra at 17-18, 23. The provisions were enacted simultaneously within the same public law. South Carolina intended to maintain its retirees' favored position. Although the motive for a benefit increase may not be entirely dispositive of the constitutional question, South Carolina's concession of linkage, along with the simultaneity of the enactments, is highly relevant. See App. 3a ("[t]he State does not dispute that the General Assembly increased retirement benefits to compensate state retirees, in part, for their increased income tax obligations resulting from the enactment of Act 189"). In addition, the coverage of the new tax and that of the new benefits substantially overlap. See *Sheehy*, 864 P.2d at 768 (noting the identical scope of Montana's new tax and benefit regimes). Similarly, while the correlation between South Carolina's new taxes on its retirees and the new benefits it pays to them is not absolutely dollar for dollar, see App. 6a, Act 189's seven percent increase in benefits for state retirees was designed to offset their increased tax obligations as closely as possible, and the State has *acknowledged* the linkage between the two. See *supra* at 17-18; App. 3a. The State was attempting to replace a discriminatory tax exemption with a discriminatory tax rebate.

Indeed, there is little legitimate justification for the usual deference to state compensation decisions here; increasing the benefits of those already retired does not encourage them to maintain their state employment. Under the circumstances presented, the *Ward* court should have considered the repealed tax exemption and the increased benefits jointly and should have held that the increased benefits are a discriminatory "tax rebate denominated otherwise in an attempt to evade the requirements of federal law." *Sheehy*, 864 P.2d at 768.

* * * *

In sum, this Court should grant the petition to resolve the conflict among the state courts on the important and recurring issue of constitutional law presented by the petition, to

overturn the state court decisions that cannot be reconciled with this Court's decisions in *Davis* and *West Lynn Creamery*, and to hold that linking the repeal of a discriminatory tax exemption with an offsetting increase in those benefits violates the non-discrimination mandate of the intergovernmental tax immunity doctrine.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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March 8, 2004

APPENDIX A

SUPREME COURT OF SOUTH CAROLINA

No. 25758

DORIS STIEGLITZ WARD, individually and on behalf of all others similarly situated,

Appellants,

v.

STATE OF SOUTH CAROLINA,

Respondent.

Heard Sept. 25, 2003
Decided Dec. 8, 2003

Justice Burnett:

Appellant Doris Stieglitz Ward brings this direct appeal on behalf of a class of federal retirees challenging the circuit court's decision upholding the constitutionality of Act 189, 1989 Acts 623 (Act 189). Federal retirees claim that South Carolina discriminates in taxation between state and federal retirees in violation of the federal constitutional and statutory intergovernmental tax immunity doctrine. For the following reasons, we affirm the judgment of the circuit court.

ISSUE

Did the circuit court err in holding that Act 189 does not violate the intergovernmental tax immunity doctrine now codified in 4 U.S.C. § 111 (1997)[1] and is therefore constitutional?

[1] That Section provides in relevant part, "The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation."

DISCUSSION

Statutes are to be construed in favor of constitutionality, and this Court will presume a legislative act is constitutional, unless its repugnance to the Constitution is clear and beyond a reasonable doubt. *Main v. Thomason*, 342 S.C. 79, 86, 535 S.E.2d 918, 921 (2000).

The South Carolina General Assembly enacted Act 189 to comply with the United States Supreme Court decision in *Davis v. Michigan Dept't of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989). In *Davis*, the Supreme Court held that the Michigan Income Tax Act violated the doctrine of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees. The Michigan statute exempted retirement benefits paid by state and local governments from state income taxes without exempting retirement benefits paid by the federal government from state income taxes. The Supreme Court stated, "It is undisputed that Michigan's tax system discriminates in favor of retired state employees and against retired federal employees." *Id.* at 814, 109 S.Ct. at 1507, 103 L.Ed.2d at 904.

To resolve the unconstitutional taxation provision, the Supreme Court declared that a mandate of "equal treatment" would remedy the constitutional infirmity in the Michigan statute. The Supreme Court stated:

> [A]ppellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. * * * [T]he Michigan courts are in the best position to determine how to comply with the mandate of equal treatment.

Id. at 818, 109 S.Ct. at 1509, 103 L.Ed.2d at 907.

Prior to *Davis*, South Carolina exempted all state retirement benefits from income taxation, but only exempted the first $3,000 of federal retirement benefits. Act 189, § 39 repealed the tax exemption for state retirement benefits, thereby rendering all federal and state retirement benefits in excess of $3,000 taxable. In addition to repealing the tax exemption, the General Assembly simultaneously increased retirement benefits for state and local retirees by 7%. Act 189, § 60. This increase in benefits is provided to all state retirees, regardless of their tax liability. The State does not dispute that the General Assembly increased retirement benefits to compensate state retirees, in part, for their increased income tax obligations resulting from the enactment of Act 189.

Federal retirees contend that Act 189 is unconstitutional because the State continues to discriminate against federal retirees by increasing the pension benefits paid to state and local retirees in an effort to offset the increased tax liability resulting from the exemption. In other words, federal retirees argue that the State has indirectly recast the pre-*Davis* discriminatory exemption through the 7% increase in benefits for state retirees. We disagree. For the following reasons, we conclude Act 189 is not, in effect, a "tax rebate" that implicates the intergovernmental tax immunity doctrine.

First, the doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income. The Tenth Amendment provides, "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively or to the people." U.S. Const. amend X. To determine if a statute violates the Tenth Amendment, we must first determine whether the regulation it embodies is within those enumerated in the Constitution. Second, we must determine whether the regulation employed impermissibly infringes upon state

sovereignty. *United States v. Johnson*, 114 F.3d 476, 480 (4th Cir.1997) *referring to New York v. United States*, 505 U.S. 144, 156, 112 S.Ct. 2408, 2418, 120 L.Ed.2d 120, 137 (1992). The power to compensate state retirees is clearly not delegated to the United States by the Constitution. As long as federal and state retirees are taxed equally, any restriction on this authority would violate the Tenth Amendment.

Second, in enacting Act 189, the General Assembly specifically followed the dictate of *Davis* by eliminating the tax exemption for both state and federal employees. In doing so, the General Assembly was guided by the remedies suggested by the Supreme Court. In direct response to *Davis*, the General Assembly amended South Carolina's tax statute to remove the tax exemption for state retirees. Act 189 conformed South Carolina to the requirements of the *Davis* decision.

Federal retirees argue the "indisputable linkage" between the increase in compensation and the tax exemption renders Act 189 unconstitutional under *Davis*. They argue that the Court must consider substance over form in evaluating the constitutionality of Act 189. *See West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 201, 114 S.Ct. 2205, 2215, 129 L.Ed.2d 157, 171 (1994) (holding in a dormant Commerce Clause case, that it is not the form by which a state discriminates, but whether the means employed will result in discrimination). We do not believe *Davis* holds, or otherwise implies, that states may only raise retirement benefits for its state's retirees if the pension increase in no way serves to offset a prior tax exemption. Even if the elimination of the tax exemption for state retirees and the simultaneous increase in benefits are read together, the doctrine of intergovernmental tax immunity is not violated. South Carolina has specifically followed the remedy prescribed by *Davis*. Therefore, federal retirees' argument is unavailing.

Third, neither *Davis* nor 4 U.S.C. § 111 prohibit the State from contracting with its retirees on the level of compensation paid to its retirees. The intergovernmental tax immunity doctrine serves to protect each sovereign's governmental operations from undue interference from the other. *Davis*, 489 U.S. at 814, 109 S.Ct. at 1507, 103 L.Ed.2d at 904. *Davis* does not hold, nor does it even suggest, that a state is prohibited from adjusting the compensation of its employees, even if the state's purpose is to compensate its employees for the loss of the income tax exemption. A state is entitled to raise the level of taxable compensation of its employees if it so chooses. *Davis* requires that the state *tax* federal and state retirees equally and does not concern itself with the manner in which a state chooses to *compensate* its retirees.

The Supreme Court implicitly recognized that a state's response to the Court's decision could be to increase compensation to state retirees to offset what those retirees lost in benefits as a result of being taxed. In his dissenting opinion, Justice Stevens stated:

> Even if it were appropriate to determine the discriminatory nature of a tax system by comparing the treatment of federal employees with the treatment of another discrete group of persons, it is peculiarly inappropriate to focus solely on the treatment of state governmental employees. *The state may always compensate in pay or salary for what it assesses in taxes.* Thus a special tax imposed only on federal and state employees nonetheless may reflect the type of disparate treatment that the intergovernmental tax immunity forbids because of the ability of the State to adjust any special tax burden on them . . . It trivializes the Supremacy Clause to interpret it as prohibiting the States

> from providing through this limited tax exemption *what the state has an unquestionable right to provide through increased retirement benefits.*

489 U.S. at 824, 109 S.Ct. at 1512, 103 L.Ed.2d at 910-911. (emphasis added).

Although the majority disagreed with the first sentence in the above passage, they took no issue with a state's ability to lawfully increase the benefits paid to state retirees to offset the effect of the Court's holding. South Carolina's increase is the type of response to *Davis* specifically contemplated by the Supreme Court. The doctrine of intergovernmental tax immunity does not apply because there is no discrimination in taxation on account of the source of compensation.

Fourth, we find no direct correlation between state retirees' state tax obligations and the amount of increased retirement benefits. All eligible state retirees receive the 7% increase in retirement benefits. Act 189 resulted in an increase in compensation for state retirees, and was not a dollar for dollar offset. Moreover, the increased benefits are subject to both state and federal taxation. In *Davis*, the majority stated, "[t]axes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar." *Davis*, 489 U.S. at 815, 109 S.Ct. at 1507, 103 L.Ed.2d at 905. The General Assembly's increase in retirement actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury.

Federal retirees rely on *Sheehy v. Public Employees Retirement Div.*, 262 Mont. 129, 864 P.2d 762 (1993) and *Vogl v. Dep't of Revenue*, 327 Or. 193, 960 P.2d 373 (1998). In *Sheehy*, federal retirees challenged Montana's 1991 statute enacted in response to *Davis*. Before *Davis*, Montana, like South Carolina, taxed federal retirement benefits but ex-

empted state retirement benefits. The Montana statute restructured the income tax on pension benefits by equalizing the taxation of all pension benefits. In the same act, the Montana legislature granted to state retirees who were Montana residents, and who were now to be taxed in response to *Davis*, an annual retirement adjustment payment. *Sheehy*, 864 P.2d at 764. The Montana Supreme Court held that the Montana statute violated the intergovernmental tax immunity provision of 4 U.S.C. § 111. The court stated,

> It is clear that the adjustment is not an actual and legitimate pension or retirement benefit. If it were a pension benefit, the State would have provided it to all of its retirees in recognition of their years of public service rather than just those living in Montana. There was no need to do so because the sole purpose of the adjustment was to partially recompense state retirees living in Montana for the tax they must pay under the equalizing provisions of [the Montana law].

864 P.2d at 768.

Federal retirees argue that South Carolina's Act 189, like the Montana statute, constitutes discriminatory taxation in violation of intergovernmental tax immunity principles. We disagree. In reaching their decision, the Montana Supreme Court relied heavily on the fact the adjustment was provided only to state retirees who are Montana residents. South Carolina's statute is distinguishable. Act 189 provides the increase to all state retirees, regardless of their domicile.

The Oregon statute considered by the Oregon Supreme Court in *Vogl* is also distinguishable from Act 189. The 1995 Oregon statute explicitly stated that its purpose was to compensate for damages. Furthermore, the benefit increases under the 1995 statute were mathematically correlated to replace the lost state retirement income. South Carolina's General Assembly did not tie the pension benefit increase,

dollar for dollar, to the lost tax exemption, nor did it declare that Act 189 was designed to compensate state retirees for damages. South Carolina's Act 189 is analogous to the 1991 statute considered by the Oregon Supreme Court in *Ragsdale v. Dep't of Revenue*, 321 Or. 216, 895 P.2d 1348 (1995). In 1991, the Oregon legislature repealed the tax exemption for state retirees and simultaneously increased the benefits for state retirees.[2] Like Act 189, Oregon's 1991 act provided no direct correlation between the increase in benefits for state retirees and their tax obligations. *Id.* at 1350.

Federal retirees have failed to show beyond a reasonable doubt that Act 189 is clearly repugnant to the Constitution. Accordingly, we affirm.

AFFIRMED.

WALLER, A.C.J., and Acting Justices H. SAMUEL STILWELL, WILLIAM L. HOWARD and J. MARK HAYES, concur.

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[2] A Virginia statute, recently considered by a Virginia circuit court, is also similar to Act 189. In *Almeter v. Virginia Department of Taxation*, 2000 WL 1687589 (Va. Cir. Ct. Nov.6, 2000), *petition denied, cert. denied*, 534 U.S. 889, 122 S.Ct. 202, 151 L.Ed.2d 143 (2001), federal retirees brought a class action seeking a refund of state income taxes that they alleged were illegally collected from them following that state's 3% increase in retirement benefits for its state's retirees. Like the present case, federal retirees alleged that the 3% increase was designed to offset the new tax liability incurred by state retirees and therefore violated the intergovernmental tax immunity doctrine. The Virginia circuit court dismissed the federal retirees' claims in holding that the increase in benefits was a remedy specifically envisioned by the Supreme Court in *Davis*.

APPENDIX B

IN THE COURT OF COMMON PLEAS
STATE OF SOUTH CAROLINA
County of Richland

[Filed Sept. 17, 2002]

C.A. No. 98-CP-40-4069

DORIS STIEGLITZ WARD, individually and on behalf of all other similarly situated,

Plaintiffs,

v.

STATE OF SOUTH CAROLINA,

Defendant.

ORDER DENYING PLAINTIFFS' MOTION TO ALTER OR AMEND JUDGMENT

Pursuant to Rule 59(e), SCRCP, Plaintiffs have moved the Court to alter or amend the judgment set forth in the Court's August 26, 2002 Order. The Court has reviewed Plaintiffs' motion and finds no basis for altering or amending its judgment.

IT IS SO ORDERED.

/s/ L. Casey Manning
THE HONORABLE L. CASEY MANNING
Circuit Judge, Fifth Judicial Circuit

Columbia, South Carolina

September 17, 2002

APPENDIX C

IN THE COURT OF COMMON PLEAS
STATE OF SOUTH CAROLINA
County of Richland

[Filed Aug. 26, 2002]

C.A. No. 98-CP-40-4069A

DORIS STIEGLITZ WARD, individually and on behalf of all other similarly situated,

Plaintiffs,

v.

STATE OF SOUTH CAROLINA,

Defendant.

ORDER

In this challenge to South Carolina's taxation of retirement income under Act No. 189 of 1989, Plaintiff, for herself and on behalf of a class of federal retirees, seeks a declaration that Act 189 is unconstitutional. Defendant State of South Carolina ("the State") has moved for summary judgment, seeking a declaration that Act 189 is constitutionally valid and that Plaintiffs three constitutional claims should be dismissed. Plaintiff[1] has moved for partial summary judgment, seeking a declaration that Act 189 is unconstitutional on the ground that it violates the intergovernmental tax immunity doctrine. After reviewing the parties' written submissions, as well as hearing oral argument, the Court has concluded that the State's motion for summary judgment

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[1] For simplicity's sake, this Order refers to "Plaintiff," with the understanding that Plaintiff has brought this suit as a class action on behalf of federal retirees.

should be granted, and Plaintiffs motion for partial summary judgment should be denied.

FACTUAL/PROCEDURAL BACKGROUND

In 1989, the United States Supreme Court held that states could not exempt state retirement benefits from state income taxation and not provide a like exemption for federal retirement benefits. *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). Prior to *Davis*, South Carolina exempted all state retirement benefits from income taxation, but only exempted the first $3,000 of other retirement benefits (including federal benefits). To comply with *Davis*, in 1989, the South Carolina General Assembly passed Act 189, which repealed South Carolina's exemption from taxation of state retirement benefits. The result was that *all* federal and state retirement benefits in excess of $3,000 became taxable. The Legislature simultaneously increased state retirement benefits by 7%.

Some nine years after Act 189's passage, Doris Ward, a federal retiree, commenced this action on behalf of all other federal retirees, contending that the Legislature's repeal of the total exemption from income taxation and its simultaneous enactment of an increase in state retirement benefits violated her rights because these actions resulted in, what she characterizes as, an unlawful "tax rebate" to state retirees. Plaintiff maintains that federal retirees are entitled to a refund of state income taxes paid on their retirement benefits. Although Plaintiff has not specified the amount of damages she is seeking on behalf of all federal retirees, she does not dispute that the damages sought total several hundred million dollars. She also seeks a permanent injunction enjoining further taxation of federal retirees' retirement benefits in excess of $3,000. Plaintiff's amended complaint alleges a statutory violation of 4 U.S.C. § 111 and constitutional

violations of the intergovernmental tax immunity doctrine, the takings clause, and equal protection.

In September 1999, the Honorable Alison Lee dismissed Plaintiff's action for failure to exhaust administrative remedies. In November 2000, the South Carolina Supreme Court overturned the dismissal, reasoning that the sole issue in the case was the determination of Act 189's constitutionality, which could only be made by a court, not an agency or an administrative law judge. *Ward v. State*, 343 S.C. 14, 538 S.E.2d 245 (2000). That issue is now before this Court on cross motions for summary judgment.

LAW/ANALYSIS

I. Legal Standard for Declaring Statute Unconstitutional

Plaintiff bears a very heavy burden in attempting to prove that Act 189 is unconstitutional. The Supreme Court has declared that "[a]ll statutes are presumed constitutional and will, if possible, be construed so as to render them valid." *Last v. MSI Constr. Co.*, 305 S.C. 349, 352, 409 S.E.2d 334, 336 (1991). Recently, the state Supreme Court again underscored the very high standard for declaring a statute unconstitutional: "A legislative enactment will be declared unconstitutional only when its invalidity appears *so clearly as to leave no room for reasonable doubt* that it violates some provision of the Constitution." *Main v. Thomason,* 342 S.C. 79, 86, 535 S.E.2d 918, 921 (2000) (emphasis added). For the reasons set forth below, the Court concludes that Plaintiff cannot meet this standard on any of her three claims.

II. Intergovernmental Tax Immunity Claim

Plaintiff argues that Act 189 is unconstitutional under the intergovernmental tax immunity doctrine, which prohibits discriminatory taxation.[2] As explained below, Plaintiff's

[2] Plaintiff has separately pled the violation of 4 U.S.C. § 111, which provides in relevant part: "The United States consents to the taxation of

argument is inconsistent with the binding decisions of the United States and South Carolina Supreme Courts, as well as persuasive authority from other courts. Thus, the Court finds that Plaintiff cannot prove the invalidity of Act 189 "so clearly as to leave no room for reasonable doubt." *See Thomason*, 342 S.C. at 86, 535 S.E.2d at 921.

A. The United States Supreme Court's *Davis* Decision

The starting point for determining the constitutional validity of Act 189 is the United States Supreme Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803. In *Davis*, the Supreme Court struck down a Michigan statute on the basis of the intergovernmental tax immunity doctrine. The statute in question fully taxed all federal retirement benefits, but excluded from taxable income retirement benefits received from the state of Michigan. The Supreme Court held that Michigan could not discriminate between state and federal retirement benefits in taxing, based on "the source" of the benefits. *Id.* at 817. When *Davis* was decided, Michigan and 22 other states, including South Carolina, gave such preferential treatment to state and local employees. *Davis* offered guidance on how the situation could be remedied: "either by extending the tax exemption to retired federal employees . . . or by eliminating the exemption

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pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation." Case law holds that 4 U.S.C. § 111 codifies the constitutional doctrine of intergovernmental tax immunity. Thus, the analysis is the same under the Constitution and 4 U.S.C. § 111. *See Davis*, 489 U.S. at 813-14 ("[T]he retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. . . . [T]he scope of the immunity granted or retained by the nondiscrimination clause [in § 111] is to be determined by reference to the constitutional doctrine.").

for retired state and local government employees." *Id.* at 818; *see Evans v. State*, 344 S.C. 60, 543 S.E.2d 547 (2001). South Carolina chose the latter option. It enacted Act 189, which eliminated the tax exemption for retired state and local government employees. Because South Carolina complied with the very guidance provided in *Davis*, Act 189 is constitutionally valid. The United States Supreme Court would obviously not have suggested an unconstitutional solution.

Plaintiff, however, criticizes South Carolina's choice. She alleges that because in addition to eliminating the tax exemption for state retirees, the State also gave its retirees a 7% increase in retirement benefits, such an increase constitutes a prohibited "tax rebate," which violates the intergovernmental tax immunity doctrine.[3]

For several major reasons, Plaintiff's argument is without merit. First, as discussed above, *Davis* provided states with two options for eliminating discriminatory taxation of federal and state retirees. A state could tax federal and state retirees alike, or it could tax neither. South Carolina chose to tax federal and state retirees alike. *Davis* did not place any

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[3] Plaintiff characterizes the 7% increase in retirement benefits as a "tax rebate"; however, the Court finds this characterization is inappropriate for two reasons. First, there has been no showing that state retirees have ever received anything resembling a "tax rebate." There has been no contention that state retirees have received a check rebating them taxes they have paid. Nor has there been any showing that state retirees have been allowed to take a credit on their tax returns to make up for the elimination of their former tax exemption. Thus, state retirees have not received a rebate in any sense of the word. Second, the increase in retirement benefits (coupled with the elimination of the tax exemption on retirement benefits) cannot be characterized as a "tax rebate" because there was no precise correlation between the increase in benefits and the taxes paid by state retirees. Under Act 189, the increase in state retirement benefits was not married to the amount of taxes that a state retiree paid, but rather all retirees received the same 7% increase in benefits. Many state retirees received the additional benefits, but have not paid any additional taxes.

limitations on how a state could tax all retirees, as long as they were taxed in the same manner. Plaintiff is attempting to write into the *Davis* decision the additional condition that a state is prohibited from increasing the retirement benefits of its own retirees. Such a condition does not appear in *Davis*. Under Plaintiff's theory, *any* post-*Davis* increase in state retirement benefits would be subject to challenge under the intergovernmental tax immunity doctrine and 4 U.S.C. § 111. Nothing in *Davis* supports Plaintiff's view that the United States Supreme Court intended by that decision to regulate what states could pay to their retirees.

Second, close examination of Plaintiff's argument reveals that she has confused the concepts of *taxation* and *take-home income*. When her argument is scrutinized, it becomes clear that Plaintiff is not, in fact, asserting that Act 189 has a discriminatory effect on taxation; rather, she is claiming that Act 189 has a discriminatory effect on take-home income. Indeed, it is undisputed that South Carolina taxes federal and state retirees at exactly the same rates. Plaintiff is contending that because Act 189 repealed the tax exemption previously available to state retires, but simultaneously increased retirement benefits by 7% (with the result that state retirees' take-home income is essentially the same as it was prior to Act 189), then South Carolina must be discriminating in their favor and against federal retirees. This argument is meritless as it is inconsistent with *Davis*. Contrary to Plaintiff's premise, *Davis* was not concerned with discriminatory state action in relation to take-home income, but rather with taxation. *Davis* did not deal with the take-home income of state retirees vis-á-vis federal retirees, but rather with discriminatory state action in regards to taxation of state and federal retirement income based on the source of their income. This is confirmed by review of *Davis* and subsequent cases. *Davis* speaks of the intergovernmental *tax* immunity doctrine, not of an inter-governmental *take-home income* immunity doctrine, which, of course, does not exist. Four years after *Davis* was

decided, the Supreme Court summarized the holding of *Davis*: "In *Davis* . . ., we held that a State violates the constitutional doctrine of intergovernmental tax immunity when it *taxes* retirement benefits paid by the Federal Government *but exempts from taxation* all retirement benefits paid by the State or its political subdivisions." *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 89 (1993) (emphasis added). Clearly, *Davis* prohibits only discriminatory taxation or exemption from taxation; it does not prohibit differences in take-home income between state and federal retirees.

Third, the possibility of a state increasing the compensation of its employees or retirees to make up for the lost tax exemption was even envisioned, and impliedly approved, by *Davis,* as long as the compensation did not result in a depleting of the federal treasury. In arguing that Michigan's exemption of taxation of state retirees should be upheld, the dissent in *Davis* had stated that it was "peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." *Davis*, 489 U.S. at 824 (Stevens, J., dissenting). The majority took issue with this argument. Importantly, however, the majority was not concerned with *whether* a state could "compensate in pay or salary for what it assesses in taxes," but rather *how* it did so. *See Davis*, 489 U.S. at 815 n.4; *see also Almeter v. Virginia Dep't of Taxation*, 2000 WL 1687589 (Va. Cir. Ct. 2000) ("[T]he majority [in *Davis*] took no issue with a state's ability to lawfully increase the benefits paid to state retirees to offset the effect of the Court's holding . . . ."), *petition denied*, (Va. 2001), *cert. denied*, 2001 WL 872690 (U.S. Oct. 1, 2001). The *Davis* majority highlighted that the critical question is whether such a scheme (*i.e.*, increasing retirement benefits to offset loss of state

tax exemption) would have a negative effect on the federal treasury:

> In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, [Michigan] would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. This fact serves to illustrate the impact on the Federal Government of [Michigan's] discriminatory tax exemption for state retirees. *Taxes enacted to reduce [Michigan's] employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.*

Davis, 489 U.S. at 815 n.4 (internal citation omitted) (emphasis added). Thus, the Supreme Court was clear that "the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar" is that which reduces a state's employment costs "at the expense of the federal treasury." *Id.* By granting a tax exemption rather than increasing the salaries or benefits of state employees, a state may, in effect, be cheating the federal government. The scheme enacted by South Carolina's Act 189 is not "the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar" because it does not "reduce the State's employment costs at the expense of the federal treasury." *Id.* On the contrary, through Act 189's 7% increase in retirement benefits, South Carolina has voluntarily *increased* its employment costs, while at the same time *bolstering* the federal treasury. Act 189 results in state retirees having to pay *more* federal income tax because the income on which their federal tax is assessed has increased. Consequently, by eliminating the exemption for state retirees and providing the benefits increase, South Carolina is adding to, not taking away from, the federal treasury. Therefore, Act

189 does not create the type of scheme that was of concern to the *Davis* Court.

Fourth, that Act 189 is consistent with *Davis* is supported by the South Carolina Supreme Court's own interpretation of *Davis*. Recently, the South Carolina Supreme Court interpreted *Davis* as follows:

> In *Davis* . . ., the United States Supreme Court held the doctrine of intergovernmental immunity and 4 U.S.C. § 111 (1997) prohibit the states from taxing federal government retirees at a *greater rate* than state and local government retirees are taxed.

Evans v. State, 344 S.C. 60, 63, 543 S.E.2d 547, 548 (2001) (emphasis added). A review of Act 189 makes clear that the Act does not tax federal government retirees at a "greater rate" than state retirees. All retirees, including federal and state, are taxed at precisely the same rate. Therefore, the state Supreme Court's own interpretation of *Davis* indicates that Act 189 is constitutionally valid.

Thus, all of the above reasons clearly indicate that Act 189 does not violate the intergovernmental tax immunity doctrine of the Constitution and 4 U.S.C. § 111. Nevertheless, Plaintiff insists that she has conclusively demonstrated a violation of the intergovernmental tax immunity doctrine because Act 189 "linked" the elimination of the full tax exemption for state retirees with the 7% increase in their retirement benefits. The Court rejects this argument.

Plaintiff's "linkage" argument is essentially a non-sequitur. Simply because the elimination of the tax exemption may have been "linked" to the increase in retirement benefits does not logically or legally lead to the conclusion that Act 189 violated the intergovernmental tax immunity doctrine. There is nothing in the intergovernmental tax immunity doctrine, as expounded in *Davis* and other Supreme Court decisions, that supports Plaintiff's argument. As the authorities cited above

clearly demonstrate, the focus of this doctrine is on discriminatory *taxation*. That Act 189 may have linked or not linked the elimination of a tax exemption with an increase in retirement benefits has absolutely no bearing on the claim that Plaintiff has asserted. Accordingly, Plaintiff has not established a violation of the intergovernmental tax immunity doctrine. Because Act 189 is constitutionally valid, the Court grants summary judgment to the State.

B. Persuasive Authority from Other Courts

The decisions of other courts also powerfully support a finding that Act 189 is constitutionally valid. The most recent decision on the question held that federal retirees, asserting claims nearly identical to those by Plaintiff in this case, did not have a cause of action. In *Almeter v. Virginia Department of Taxation*, 2000 WL 1687589 (Va. Cir. Ct. Nov. 6, 2000), *petition denied,* (Va. 2001), *cert. denied,* 2001 WL 872690 (U.S. Oct. 1, 2001), federal retirees sought a refund of state income taxes "illegally and unconstitutionally collected from them" and "a declaration that a 3% 'Tax Rebate'" contained in a post-*Davis* Virginia statute violated the federal and state constitutions. More specifically, the federal retirees alleged that the state's increase of retirement allowance by 3% for state retirees violated the intergovernmental tax immunity doctrine under 4 U.S.C. § 111, as this was an "attempt to give state retirees the same benefits they had before *Davis* and, thus, avoid *Davis*' holding." *Almeter*, 2000 WL 1687589. The *Almeter* Court summarily dismissed the federal retirees' claims. *Almeter*, which cannot be meaningfully distinguished from the current case, unequivocally points to the rejection of Plaintiff's claim here.

That South Carolina's Act 189 is constitutionally valid also finds compelling support in an *en banc* decision of the Supreme Court of Oregon, which squarely held that a scheme similar to South Carolina's did not violate the

intergovernmental tax immunity doctrine. *Ragsdale v. Department of Revenue*, 895 P.2d 1348 (Or. 1995)(en banc). In response to *Davis*, the Oregon legislature, like South Carolina's, repealed the tax exemption for state retirees. At the same time, Oregon increased state retirement benefits. Federal retirees brought a lawsuit asserting that the legislature's actions violated the intergovernmental tax immunity doctrine. The Oregon Supreme Court explicitly rejected the federal retirees' assertion and agreed instead with the lower court, which had held that "*Davis* does not hold, or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the [income tax] exemption." *Ragsdale*, 895 P.2d at 1356. Addressing precisely the same argument that Plaintiff makes in the current case, the Court declared: "The 1991 increase in compensation is not transformed into a tax rebate or tax benefit simply because it was motivated in whole or in part as a response to the *Davis* decision and the consequent removal of the tax exemption for [state] retirement benefits." *Id.* at 1354.

The Oregon Supreme Court gave several reasons why there was no discrimination against federal retirees: (1) there is no indication in *Davis* that the doctrine of intergovernmental tax immunity concerns itself with the level of compensation that a state pays its state retirees; (2) it would be illogical to suggest that there is anything in the underlying principle of intergovernmental tax immunity that would invalidate a state compensation plan in aspects unrelated to the level of taxation; (3) the legislative acts had conformed to the remedies set forth in *Davis*; (4) the increase in benefits is not part of the state's taxation; and (5) there is no correlation between state retirees' state tax obligations and the amount of increased retirement benefits to which they may be entitled. *Ragsdale*, 895 P.2d at 1354-55. Each of these reasons also

reinforces the view that South Carolina's Act 189 does not violate the doctrine of intergovernmental tax immunity.[4]

Ignoring the clear reasoning of *Ragsdale*, Plaintiff seeks the application of a later, but distinguishable, Oregon decision. *See Vogl v. Department of Revenue*, 960 P.2d 373 (Or. 1998). *Vogl* addressed a 1995 statute that increased retirement benefits to compensate for damages suffered by state retirees as a result of their benefits being subject to state personal income taxes. The Oregon Court ruled that the 1995 statute violated the intergovernmental tax immunity doctrine. In reaching this conclusion, the Court expressly preserved its holding and analysis in *Ragsdale*: "We emphasize that our holding necessarily is confined to the 1995 statute. *We do not overrule Ragsdale or its analysis of the 1991 law.*" *Vogl*, 960 P.2d at 383 (emphasis added). *Vogl* stated, "unlike the flat percentages employed by the 1991 statute, the 1995 statute increases benefits by way of a formula that is fairly closely matched to the task of replacing [state retirement] income that will be lost to taxes." *Vogl*, 960 P.2d. at 379. *Vogl* thus supports the State's position, rather than Plaintiff's, in the current case. South Carolina's Act 189 is distinguishable because Act 189 made no effort to tie increased benefits to individual tax circumstances, as was the case in Oregon. All state retirees' benefits in South Carolina were increased by 7%, regardless of the amount lost to taxes as a result of the elimination of the tax exemption. Thus, *Vogl* does not advance Plaintiff's argument that Act 189 violates *Davis*.

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[4] In fact, South Carolina's Act 189 presents an even clearer case of constitutional validity. Oregon's statute, which was held to be constitutional, contained a provision declaring that increased state retirement benefits were not payable in any year in which the retirement benefits were exempt from personal income taxation. *Ragsdale*, 895 P.2d at 1358 (Gillete, J., dissenting). In other words, the distribution of the increased retirement benefits was conditioned upon the retirement benefits being taxed that year. South Carolina's Act 189 contains no such condition.

Plaintiff also erroneously relies upon a decision from Montana, *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762 (Mont. 1993), which declared as violative of *Davis* a statute granting to state retirees who were Montana residents, and who were to be taxed, an annual retirement adjustment payment. The Montana Court found that the adjustment was not a legitimate retirement benefit because it was "provided not to all state retirees, but only to state retirees who are Montana residents." *Id.* at 769. "It is clear that the adjustment is not an actual and legitimate pension or retirement benefit. If it were a pension benefit, the State would have provided it to all of its retirees in recognition of their years of public service rather than just those living in Montana." *Id.* at 768. Unlike Montana's retirement benefit increase, South Carolina's is not just limited to state retirees living within the state, but applies to all South Carolina retirees, within and without the state. Thus, *Sheehy* actually supports the validity of South Carolina's Act 189.

In sum, the Court finds that the cases most analogous to the current case are *Almeter* and *Ragsdale*, which have directly rejected the same "tax rebate" argument that Plaintiff makes here. Accordingly, these authorities point to a finding of the constitutional validity of Act 189, in the same way as do the previously-discussed decisions of the United States Supreme Court and the South Carolina Supreme Court.[5]

III. Takings Claim

The State has also moved for summary judgment on Plaintiff's constitutional "takings" claim. Plaintiff asserted in

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[5] In addition to all the aforementioned reasons pointing to the constitutionality of Act 189, the Tenth Amendment to the United States Constitution provides another. A finding that Act 189 is unconstitutional would raise serious questions as to the violation of the Tenth Amendment, which declares that the "powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States . . . ." U.S. Const. amend. X.

her complaint that the taxation of the retirement benefits of federal retirees constitutes a taking of private property for public use without just compensation, in violation of the federal and state constitutions. In response to the State's motion for summary judgment, Plaintiff has offered no opposition on the issue of takings. Thus, the Court deems Plaintiff to have abandoned this claim.

However, even had Plaintiff not abandoned her takings claim, it would still fail on the merits. It is clear that the State has "taken" nothing from Plaintiff or any other federal retiree. Plaintiff's argument is really that the State has not "given" her (a) an increase in retirement benefits, or (b) tax-free treatment on her federal retirement income. Obviously, she has no entitlement to the former, as she was not a state retiree; nor does she have any right to the latter, as it is axiomatic that the State has the power to tax its residents.

Case law from the United States Supreme Court, the South Carolina Supreme Court, and courts throughout the country makes clear that taxpayers have no vested interest in tax laws remaining unchanged: "Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code." *United States v. Carlton,* 512 U.S. 26, 33 (1994); *see Rivers v. State,* 327 S.C. 271, 490 S.E.2d 261 (1997). Second, "even though taxes . . . indisputably 'take' money from individuals or businesses, assessments of that kind are not treated as *per se* takings under the Fifth Amendment." *Branch v. United States*, 69 F.3d 1571, 1576 (Fed. Cir.1995); *A. Magnano v. Hamilton,* 292 U.S. 40 (1934) (taxing power of state or federal government not considered a taking under the Fifth or Fourteenth Amendment) (cited in *Rivers*, 327 S.C. at 275-76, 490 S.E.2d at 263). Because Plaintiff has no vested interest in the receipt of a tax refund, takings law is inapplicable, and, therefore, there is no valid takings claim. *See Rivers*, 327 S.C. at 276, 490 S.E.2d at 263 (rejecting taxpayers' takings claim).

IV. Equal Protection Claim

The State has also moved for summary judgment on Plaintiff's equal protection claim. Again, Plaintiff has offered no opposition to the State's motion in regard to this claim and has, therefore, abandoned it.

Even if the Court had to consider the merits of Plaintiff's equal protection cause of action, such a cause would collapse under minimal scrutiny. It is well-settled that there is no fundamental right to the equal payment of taxes, and federal retirees do not belong to a suspect or quasi-suspect classification. Thus, in order to withstand an equal protection challenge, legislation need only be rationally related to a legitimate governmental interest. *Ohio Bureau of Employment Servs. v. Hodory*, 431 U.S. 471 (1977). "It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. Neither due process nor equal protection imposes upon a state any rigid rule of equality of taxation." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509 (1937). So long as a distinction rests upon a rational basis, inequalities which result from singling out a particular class or classes for taxation or exemptions are not unconstitutional. *Id.*; *see Quirk v. Campbell*, 302 S.C. 148, 153, 394 S.E.2d 320, 323 (1990) (in rejecting plaintiff's equal protection challenge, the Court stated that it is "elementary that if the classification bears a reasonable relation to the legislative purpose sought to be effected, and if the constituents of each class are treated alike under similar circumstances and conditions, . . . equal protection . . . is fully complied with."). When a statute does not involve a fundamental interest or affect with particularity a protected class, it is presumed to be valid. *See Hodory*, 431 U.S. at 489; *Niemann v. Niemann*, 282 S.C. 127, 129, 317 S.E.2d 472, 474 (Ct. App. 1984) ("[T]he court will presume a legislative act is constitutionally valid unless a clear showing to the contrary is made.").

Here, Act 189 increased the retirement benefits of state retirees at the same time that their tax liability increased. Because Act 189 does not involve a fundamental interest, it is presumed to be valid. *See Hodory*, 431 U.S. at 489. Moreover, that presumption is not overcome inasmuch as the State had a rational basis for enacting Act 189. Persuading good employees to seek or keep State employment is a critical governmental objective, and offering competitive retirement benefits is a means to that end. South Carolina did that by increasing retirement benefits by 7%. Thus, it is clear that Act 189 is rationally related to a legitimate governmental purpose, and equal protection is not offended. *See Davis v. County of Greenville*, 313 S.C. 459, 443 S.E.2d 383 (1994) (holding that a county's practice of taxing all residents at a uniform rate while providing certain services only to particular areas did not violate the federal or state equal protection clause).

CONCLUSION

In sum, the Court finds that Plaintiff has failed to meet her burden of establishing the unconstitutionality of Act 189 "so clearly as to leave no room for reasonable doubt." *Thomason,* 342 S.C. at 86, 535 S.E.2d at 921. Accordingly, consistent with the authorities discussed above, the Court DENIES Plaintiff's motion for partial summary judgment and GRANTS the State's motion for summary judgment. The Court hereby expressly declares that Act 189 is constitutionally valid and does not violate the intergovernmental tax immunity doctrine or 4 U.S.C. § 111. Nor does Act 189 violate the takings clause or the equal protection clauses of the federal and state constitutions.

IT IS SO ORDERED.

/s/ L. CASEY MANNING
The Honorable L. Casey Manning
Circuit Judge, Fifth Judicial Circuit

Columbia, South Carolina
August 26, 2002

APPENDIX D

SOUTH CAROLINA LEGISLATURE
ACT 189, 1989 S.C. ACTS 623

* * * *

SECTION 39

TO AMEND SECTION 12-7-435, AS AMENDED, OF THE 1976 CODE, RELATING TO DEDUCTIONS FROM SOUTH CAROLINA TAXABLE INCOME FOR PURPOSES OF THE STATE INDIVIDUAL INCOME TAX, SO AS TO LIMIT TO THREE THOUSAND DOLLARS THE DEDUCTIONS OF AMOUNTS RECEIVED FROM THE VARIOUS STATE RETIREMENT SYSTEMS, OTHER SOUTH CAROLINA POLICE OR FIREFIGHTER COUNTY OR MUNICIPAL RETIREMENT SYSTEMS, AND RETIREMENT SYSTEMS OF OTHER STATES; TO AMEND SECTIONS 9-1-1680, AS AMENDED, 9-8-190, 9-9-180, AND 9-11-270, RELATING TO THE TAX EXEMPTION ALLOWED RETIREMENT BENEFITS OF THE VARIOUS STATE RETIREMENT SYSTEMS, SO AS TO DELETE THE EXEMPTIONS FROM THE STATE INDIVIDUAL INCOME TAX AND THE SOUTH CAROLINA ESTATE TAX; AND TO REPEAL SECTION 12-7-565 RELATING TO RECIPROCAL AGREEMENTS WITH OTHER STATES ON THE TAXING OF RETIREMENT BENEFITS.

A. Item (d) of Section 12-7-435 of the 1976 Code is amended to read:

> "(d) The first three thousand dollars of the total amount received by a taxpayer from the various state retirement systems as provided in Title 9 and from the retirement systems of other states."

B. Item (e) of Section 12-7-435, as amended by Section 25E, Part II, Act 170 of 1987, is further amended to read:

"(e) The first three thousand dollars of retirement pay received by police officers or firemen from a South Carolina municipality or county group retirement plan."

C. Section 9-1-1680 of the 1976 Code, as amended by Act 297 of 1988, is further amended to read:

"Section 9-1-1680. The right of a person to an annuity or a retirement allowance or to the return of contributions, an annuity, or retirement allowance itself, any optional benefit, or any other right accrued or accruing to any person under the provisions of this chapter, and the monies of the system created under the provisions of this chapter or any private retirement system operated by a municipality, are exempted from any state or municipal tax, except the taxes imposed pursuant to Chapters 7, 15, and 16 of Title 12, and exempted from levy and sale, garnishment, attachment, or any other process and are unassignable except as specifically otherwise provided in this chapter."

D. Section 9-8-190 of the 1976 Code is amended to read:

"Section 9-8-190. The right of a person to a retirement allowance or to the return of contributions, a retirement allowance itself, any optional allowance or payment on death or any other right accrued or accruing to any person under the provisions of this chapter, and the monies of the system are exempted from state or municipal tax, except the taxes imposed pursuant to Chapters 7, 15, and 16 of Title 12, and exempted from levy and sale, garnishment, attachment, or any other process and are unassignable except as otherwise provided in this chapter."

E. Section 9-9-180 of the 1976 Code is amended to read:

"Section 9-9-180. The right of a person to a retirement allowance or to the return of contributions, a retirement allowance itself, any optional allowance or payment on

death or any other right accrued or accruing to any person under the provisions of this chapter, and the monies of the system are exempted from any state or municipal tax, except the taxes imposed pursuant to Chapters 7, 15, and 16 of Title 12, and exempted from levy and sale, garnishment, attachment, or any other process and are unassignable except as specifically otherwise provided in this chapter."

F. Section 9-11-270 of the 1976 Code is amended to read:

"Section 9-11-270. The right of a person to retirement allowance or to the return of contributions, a retirement allowance itself, any optional or death benefit, or any other right accrued or accruing to a person under the provisions of this chapter, and the monies of the system are exempted from any state or municipal tax, except the taxes imposed pursuant to Chapters 7, 15, and 16 of Title 12, and exempted from levy and sale, garnishment, attachment, or any other process, and are unassignable except as specifically otherwise provided in this chapter."

G. Section 12-7-565 of the 1976 Code is repealed.

H. This section is effective for taxable years beginning after 1988 and with respect to estates of decedents dying after 1988.

* * * *

SECTION 60

TO AMEND SECTIONS 9-1-1220, 9-1-1550, AS AMENDED, AND 9-1-1767 OF THE 1976 CODE, RELATING TO THE SOUTH CAROLINA RETIREMENT SYSTEM, SO AS TO INCREASE EMPLOYER CONTRIBUTIONS BY FIFTY-FIVE HUNDREDTHS OF ONE PERCENT, TO INCREASE THE MULTIPLIER FRACTION USED IN CALCULATING SERVICE RETIREMENT BENEFITS FROM ONE AND THIRTY-FIVE HUNDREDTHS PER-

CENT TO ONE AND FORTY-FIVE HUNDREDTHS PERCENT OF AVERAGE FINAL COMPENSATION FOR CLASS ONE MEMBERS AND FROM ONE AND SEVENTENTHS PERCENT TO ONE AND EIGHTY-TWO HUNDREDTHS PERCENT OF AVERAGE FINAL COMPENSATION FOR CLASS TWO MEMBERS, TO INCREASE THE BENEFITS PAYABLE DUE TO RETIREMENT BEFORE JULY 1, 1989, BY SEVEN PERCENT EFFECTIVE ON THAT DATE; TO AMEND SECTION 9-8-60, RELATING TO THE RETIREMENT SYSTEM FOR JUDGES AND SOLICITORS, SO AS TO INCREASE THE MONTHLY RETIREMENT BENEFIT; TO AMEND SECTION 9-9-60, RELATING TO THE RETIREMENT SYSTEM FOR MEMBERS OF THE GENERAL ASSEMBLY, SO AS TO INCREASE THE MONTHLY RETIREMENT BENEFIT; TO AMEND SECTIONS 9-11-60, AS AMENDED, AND 9-11-300, AS AMENDED, RELATING TO THE SOUTH CAROLINA POLICE OFFICERS RETIREMENT SYSTEM, SO AS TO INCREASE THE MULTIPLIER USED IN CALCULATING SERVICE RETIREMENT MONTHLY BENEFITS OF CLASS ONE MEMBERS FROM TEN DOLLARS AND TWENTY-FIVE CENTS FOR EACH YEAR OF SERVICE TO TEN DOLLARS AND NINETY-SEVEN CENTS AND TO INCREASE THE MULTIPLIER USED IN CALCULATING MONTHLY SERVICE RETIREMENT BENEFITS OF CLASS TWO MEMBERS FROM TWO PERCENT TO TWO AND FOURTEEN HUNDREDTHS PERCENT OF AVERAGE FINAL COMPENSATION, AND TO INCREASE THE BENEFITS PAYABLE DUE TO RETIREMENT BEFORE JULY 1, 1989, BY SEVEN PERCENT EFFECTIVE ON THAT DATE, AND TO PROVIDE THAT NO INTEREST OR PENALTIES MAY BE ASSESSED ON UNDERPAYMENTS OF ESTIMATED STATE INDIVIDUAL INCOME TAXES DUE FOR TAXABLE YEAR 1989 OCCURRING BECAUSE OF THE DELETION OF THE STATE INCOME TAX EXEMPTION OF STATE RETIREMENT BENEFITS.

A. Section 9-1-1220 of the 1976 Code is amended by adding at the end:

> "Effective July 1, 1989, the State Budget and Control Board shall increase the employer contribution rate for the South Carolina Retirement System by fifty-five hundredths of one percent."

B. Section 9-1-1550(A)(3) and (B) of the 1976 Code, as amended by Act 475 of 1988, are further amended to read:

> "(3) If he has a prior service certificate in full force and effect, an additional employer annuity which must be equal to the employee annuity which would have been provided at age sixty-five or at age of retirement, whichever is less, by twice the contributions which he would have made during his entire period of prior service had the System been in operation and had he contributed thereunder during such entire period. Upon retirement from service on or after July 1, 1989, a Class One member shall receive a service retirement allowance computed as follows: If the member's service retirement date occurs on or after his sixty-fifth birthday, or after he has completed thirty or more years of creditable service, the allowance must be equal to one and forty-five hundredths percent of his average final compensation multiplied by the number of years of his creditable service. If the member's service retirement date occurs before his sixty-fifth birthday and before he completes thirty years of creditable service, his service retirement allowance is computed as above, but is reduced by five-twelfths of one percent thereof for each month by which his retirement date precedes the first day of the month, prorated for periods less than a month, coincident with or next following his sixty-fifth birthday. Notwithstanding the foregoing provisions, any Class One member who retires on or subsequent to July 1, 1976, shall receive not less than the benefit provided under the formula in effect before July 1, 1976.

(B) Upon retirement from service on or after July 1, 1989, a Class Two member shall receive a service retirement allowance computed as follows:

(1) If the member's service retirement date occurs on or after his sixty-fifth birthday or after he has completed thirty or more years of creditable service, the allowance must be equal to one and eighty-two hundredths percent of his average final compensation, multiplied by the number of years of his creditable service.

(2) If the member's service retirement date occurs before his sixty-fifth birthday and before he completes the thirty years of creditable service, his service retirement allowance is computed as in item (1) above but is reduced by five-twelfths of one percent thereof for each month, prorated for periods less than a month, by which his retirement date precedes the first day of the month coincident with or next following his sixty-fifth birthday.

(3) Notwithstanding the foregoing provisions, a Class Two member whose creditable service began before July 1, 1964, shall receive not less than the benefit provided by subsection (A) of this section."

C. Section 9-1-1767 of the 1976 Code, as added by Act 475 of 1988, is amended by adding at the end:

"Effective July 1, 1989, the benefits payable due to retirement before July 1, 1989, must be increased by seven percent."

D. Section 9-8-60(2) of the 1976 Code is amended to read:

"(2) A retired member shall receive a monthly retirement allowance which is equal to one-twelfth of seventy-one and three-tenths percent of the current active salary of the respective position."

E. Section 9-9-60(2) of the 1976 Code is amended to read:

"(2) Effective July 1, 1989, a retired member shall receive a monthly retirement allowance which is equal to one-twelfth of four and eighty-two hundredths percent of earnable compensation multiplied by the number of years of his credited service prorated for periods less than a year."

F. Section 9-11-60(2) of the 1976 Code, as amended by Act 424 of 1988, is further amended to read:

"(2) Upon service retirement on or after July 1, 1989, the member shall receive a service retirement allowance which is equal to the sum of (a), (b), and (c) below:

(a) a monthly retirement allowance equal to ten dollars and ninety-seven cents multiplied by the number of years of his Class One service;

(b) a monthly retirement allowance equal to one-twelfth of two and fourteen hundredths percent of his average final compensation multiplied by the number of years of his Class Two service;

(c) an additional monthly retirement allowance which is the actuarial equivalent of the member's accumulated additional contributions.

The sum of the retirement allowances computed under (a) and (b) above may not be less than the allowance which would have been provided under (a) if all of the member's credited service were Class One service. For a police officer who became a member before July 1, 1974, and who was a participant in the Supplemental Allowance Program, the portion of his service retirement allowance not provided by his accumulated contributions may not be less than it would have been if the provisions of the System in effect on June 30, 1974, had continued in effect until his date of retirement."

G. Section 9-11-300 of the 1976 Code, as amended by Act 424 of 1988, is further amended by adding at the end:

"Benefits payable due to retirement before July 1, 1989, must be increased by seven percent effective July 1, 1989."

H. No taxpayer receiving benefits from the various state retirement systems provided in Title 9 of the 1976 Code may be assessed penalties or interest on underpayments of estimated individual income taxes for the 1989 taxable year occurring as a result of the elimination of the total exemption of those benefits from the South Carolina individual income tax.

I. This section takes effect July 1, 1989.

* * * *

(2)

No. 03-1304

Supreme Court, U.S.
FILED
APR 14 2004
OFFICE OF THE CLERK

In The

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually and on behalf of all others similarly situated,

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of South Carolina

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Did the South Carolina Supreme Court properly hold that Act No. 189 of 1989, which resulted in the imposition of the same taxation on federal and state retirement benefits, is consistent with the intergovernmental tax immunity doctrine, as interpreted in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989)?

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INTRODUCTION

This case is an outgrowth of the decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). *Davis* held that the doctrine of intergovernmental tax immunity, codified at 4 U.S.C. § 111, prohibits states from taxing income derived from federal retirement at a greater rate than income derived from state retirement. *See Davis*, 489 U.S. at 817. Under *Davis*, states could eliminate the discriminatory treatment either by taxing federal and state retirement income or by taxing neither. *Id.* at 817-18.

Prior to 1989, South Carolina exempted from taxation the first $3,000 of federal retirement income, but exempted from taxation all state retirement income. In 1989, South Carolina responded to the mandate of *Davis* by passage of Act No. 189, 1989 S.C. Acts, Part II, §§ 39, 60(B)-(G) ("Act 189").[1] Act 189 eliminated the tax exemption for state retirees. The Act also increased state retirees' retirement compensation by 7%. Nearly a decade after the passage of Act 189,[2] federal retirees ("Petitioners") initiated the current action contending that Act 189 violated the intergovernmental tax immunity doctrine. The trial court and the South Carolina Supreme Court rejected Petitioners' contention. Petitioners are now seeking review of the state supreme court's decision. For the reasons set forth below, the petition for writ of certiorari should be denied as the South Carolina Supreme Court's decision is

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[1] Codified, *inter alia*, at S.C. Code Ann. §§ 9-1-1550(A)(3) and (B), 9-1-1767, 9-8-60(2), 9-11-60(2), and 9-11-300 (Supp. 2003).

[2] *Cf.* S.C. Code Ann. § 15-3-530 (Supp. 2003) (setting forth three year statute of limitations for "an action upon a liability created by statute").

consistent with the intergovernmental tax immunity doctrine and *Davis*:

1. *Davis* required that states that had differentially taxed federal and state retirees cure the difference "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Through passage of Act 189, South Carolina chose the latter option presented by *Davis*. Petitioners are mistakenly attempting to write into the *Davis* decision the additional condition that if a state eliminates the tax exemption for state and local government employees, the state cannot also increase the retirement benefits of its own retirees. *Davis* did not set forth such a limitation. Further, such a limitation on a state's ability to alter its retirement benefits would be inconsistent with the Tenth Amendment.

2. The South Carolina Supreme Court's decision comports with *Davis* because the intergovernmental tax immunity doctrine, as codified in 4 U.S.C. § 111, is concerned with taxation and not compensation.

3. The South Carolina Supreme Court's proper application of the holding of *Davis* is indisputably confirmed by the fact that Petitioners would have paid exactly the same amount in state income taxes had state retirees not received a retirement benefits increase under Act 189. If South Carolina had taken the "constitutional" approach implied by Petitioners, by just eliminating the tax exemption for state retirees but not increasing state retirement benefits, Petitioners' state income taxes would have been precisely the same as they are under Act 189.

4. *Davis* impliedly recognized that states may increase salaries or benefits of their employees, as long as they do not do so "at the expense of the federal treasury." *Davis*, 489 U.S. at 815 n.4. By increasing the retirement benefits of its employees, South Carolina has bolstered, rather than weakened, the federal treasury.

5. The absence of a direct correlation between the amount of the retirement benefits increase under Act 189 and state retirees' new state tax obligations undermines the factual basis of Petitioners' argument that the benefits increase is simply a "tax rebate."

6. There does not exist a true conflict among the few state court decisions that have considered the issue in this case. Analysis of the relevant cases reveals that factually distinct legislative schemes have led to different conclusions by state courts considering the constitutionality of those schemes.

7. A decision by the Court in this case would have limited precedential value because there are only two other jurisdictions that could potentially directly be impacted by this case.

STATEMENT OF THE CASE

Petitioner Doris Stieglitz Ward, a federal retiree, commenced this suit on November 5, 1998 against Respondent State of South Carolina, purporting to bring this action not only on her own behalf but also on behalf of all other federal retirees – Petitioners. In their complaint, Petitioners alleged that South Carolina's Act 189 violated the constitutional doctrine of intergovernmental tax

immunity, infringed their federal and state constitutional rights to equal protection, and also constituted a taking of their property without just compensation.

In September 1999, the state trial court dismissed this action on the ground that the remedies provided by the South Carolina Revenue Procedures Act, S.C. Code Ann. § 12-60-10 *et seq.* (Cum. Supp. 1998), were exclusive, and Petitioners were required to follow those administrative procedures before seeking judicial review of their claims. Petitioners appealed the ruling to the South Carolina Supreme Court. The state supreme court reversed the trial court's order, finding that Petitioners were not required to exhaust their administrative remedies under the South Carolina Revenue Procedures Act because that "statute does not apply in cases where the sole issue is whether a statute or other legislative action is constitutional." *Ward v. State*, 538 S.E.2d 245, 248 (S.C. 2000).

Upon remand, Petitioners moved to certify a class. The trial court granted the motion. Subsequently, the parties filed cross-motions for summary judgment. After responsive briefs were filed, the trial court conducted oral argument on the motions, and on August 26, 2002, issued an order granting South Carolina's motion for summary judgment and denying Petitioners' motion for partial summary judgment. (Petition for a Writ of Certiorari, Appendix C).

Petitioners appealed the trial court's order. On appeal before the South Carolina Supreme Court, Petitioners abandoned their equal protection and takings claims and argued solely that Act 189 violated the intergovernmental tax immunity doctrine. The state supreme court rejected Petitioners' argument, holding that Act 189 was consistent

with the intergovernmental tax immunity doctrine, as interpreted by this Court in *Davis*, 489 U.S. 803. *Ward v. State*, 590 S.E.2d 30 (S.C. 2003). Petitioners are now seeking from this Court a writ of certiorari to the South Carolina Supreme Court.

REASONS FOR DENYING THE PETITION

I. THE SOUTH CAROLINA SUPREME COURT'S DECISION CONFORMS TO THE MANDATE OF *DAVIS V. MICHIGAN*.

The Court should deny the petition for writ of certiorari because the decision of the South Carolina Supreme Court in the present action is consistent with this Court's ruling in *Davis*, 489 U.S. 803. As detailed below, the state supreme court correctly concluded that Act 189, which resulted in the imposition of the same taxation on federal and state retirement benefits, does not violate the intergovernmental tax immunity doctrine, codified in 4 U.S.C. § 111.[3]

[3] While the denial of certiorari lacks precedential value, it is of interest that this Court has on two prior occasions denied certiorari on precisely the same issue presented in this case. After the Oregon Supreme Court held that that state's legislative response to *Davis v. Michigan* did not violate the intergovernmental tax immunity doctrine, *see Ragsdale v. Department of Revenue*, 895 P.2d 1348 (Or. 1995), the taxpayer petitioned this Court for writ of certiorari, raising the following issue:

> The question presented is whether a state may lawfully defeat a constitutional mandate of the Supreme Court of the United States by enacting a sham statute that purports to tax state and federal government pensions equally, but that,

(Continued on following page)

> at the same time, rebates the state tax to state government retirees in the form of an increased pension, thus attempting to avoid the federal requirement of equality of taxation of state and federal retirees in 4 USC 111 and as pronounced by this Court in *Reich v. Collins*, 513 U.S. 106, 130 L.Ed.2d 454, 115 S.Ct. 547 (1994); *Harper v. Virginia Department of Taxation*, 509 U.S. 86, 125 L.Ed.2d 74, 113 S.Ct. 2510 (1993); and *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 103 L.Ed.2d 891, 109 S.Ct. 1500 (1989).

Ragsdale v. Dep't of Revenue, 895 P.2d 1348 (1995), *petition for cert. sub nom*, *Bank of California v. Oregon Dep't of Revenue*, 1995 WL 17035874 at *5 (U.S. Oct. 10, 1995) (No. 95-592). This Court denied the petition for certiorari. *Bank of California v. Oregon Dep't of Revenue*, 516 U.S. 1011 (1995).

More recently, this Court considered a similar petition in *Almeter v. Virginia Department of Taxation*, 2000 WL 1687589 (Va. Cir. Ct. 2000), *petition denied*, (Va. 2001), *petition for cert.*, 2001 WL 34115936 (U.S. July 12, 2001) (No. 01-74). In *Almeter*, federal retirees in Virginia petitioned this Court, seeking review of a lower court decision that had rebuffed a constitutional attack on the legitimacy of Virginia's legislative response to *Davis v. Michigan*. The issue raised before this Court was:

> Whether it is constitutionally valid under *Davis* [*v. Michigan*] for Virginia to discriminate against Federal retirees by imposing a heavier tax burden on Federal retirement benefits than on State and local retirement benefits through tax rebates to State and local retirees.

Almeter, 2001 WL 34115936 at *ii. Again, this Court denied the petition for writ of certiorari. *Almeter v. Virginia Dep't of Taxation*, 534 U.S. 889 (2001).

While this Court's denials of the petitions in *Ragsdale* and *Almeter* do not have any binding effect on whether the current petition should be granted, it is noteworthy that the legal landscape has not changed since this Court's consideration of these petitions. For the substantive reasons discussed herein, the Court should also deny certiorari in the present action.

A. 4 U.S.C. § 111 and *Davis v. Michigan*

The Public Salary Tax Act, 4 U.S.C. § 111, provides in relevant part:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

As interpreted in *Davis*,

> [4 U.S.C.] Section 111 was enacted as part of the Public Salary Tax Act of 1939, the primary purpose of which was to impose federal income tax on the salaries of all state and local government employees. Prior to the adoption of the Act, salaries of most government employees, both state and federal, generally were thought to be exempt from taxation by another sovereign under the doctrine of intergovernmental tax immunity.

Davis, 489 U.S. at 810. Concerned that considerations of fairness demanded

> equal tax treatment for state and federal employees, Congress decided to ensure that federal employees would not remain immune from state taxation at the same time that state government employees were being required to pay federal income taxes. Accordingly, § 4 of the proposed Act (now § 111) expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state taxes.

. . .

> Section 111 did not waive all aspects of intergovernmental tax immunity, however. The final clause of the section contains an exception for state taxes that discriminate against federal employees on the basis of the source of their compensation. This nondiscrimination clause closely parallels the nondiscrimination component of the constitutional immunity doctrine which has, from the time of *McCulloch v. Maryland*, barred taxes that "operat[e] so as to discriminate against the Government or those with whom it deals."

Davis, 489 U.S. at 812 (internal citations omitted).[4]

Applying these principles, the *Davis* Court struck down a Michigan statute, finding it violative of 4 U.S.C. § 111. Prior to *Davis*, Michigan, like 22 other states including South Carolina, gave preferential treatment to state and local government employees, in comparison to federal employees, on the taxation of their benefits. *See Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 93 (1993). *Davis* held that the doctrine of intergovernmental tax immunity prohibits the states from taxing federal government retirees at a greater rate than state and local government retirees are taxed. *Davis*, 489 U.S. at 817. Disparate taxation of federal and state retirement income would be

[4] The Court further explained that "the retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity." *Davis*, 489 U.S. at 813.

inconsistent with 4 U.S.C. § 111's requirement that taxation "not discriminate . . . because of the source of the pay or compensation." *See* 4 U.S.C. § 111(a).

Davis declared that the appropriate remedy for Michigan's violation of the intergovernmental tax immunity doctrine and 4 U.S.C. § 111 was a mandate of "equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Davis*, 489 U.S. at 817-18 (internal quotations omitted). The Court specified that

> appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. . . . [T]he Michigan courts are in the best position to determine how to comply with the mandate of equal treatment.

Davis, 489 U.S. at 818.

B. South Carolina's Response to *Davis v. Michigan*

As noted earlier, prior to *Davis*, South Carolina gave preferential tax treatment to state and local government retirees: State retirement benefits were fully exempt from taxation in South Carolina, while only the first $3,000 of federal retirement benefits were tax-exempt. *Ward*, 590 S.E.2d at 32. In light of *Davis*'s guidance that states could cure the differential treatment "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees," *Davis*, 489

U.S. at 818, South Carolina chose the latter approach. In 1989, the State's legislature passed Act 189, which repealed the full tax exemption on state retirement benefits, thereby rendering taxable all federal and state retirement benefits in excess of $3,000. *See Ward*, 590 S.E.2d at 32 (citing Act 189, § 39). In addition to repealing the tax exemption, the General Assembly increased the retirement benefits for state and local government retirees by 7%. *Id.* (citing Act 189, § 60).

Nearly a decade after the passage of Act 189, Petitioners initiated the current action contending that South Carolina's Act 189 violated the intergovernmental tax immunity doctrine, as interpreted in *Davis*. Although Petitioners, as federal retirees, are taxed precisely the same as state retirees, Petitioners nevertheless contend that Act 189 violates 4 U.S.C. § 111 because, in addition to having eliminated the tax exemption for state retirees, the Act provided a benefits increase to state retirees. The South Carolina Supreme Court found Petitioners' argument to be without merit. For the reasons discussed below, the state supreme court's decision comports with the guidance of this Court in *Davis*, so the petition for writ of certiorari should be denied.

C. Consistency of the South Carolina Supreme Court's Decision with *Davis v. Michigan*

This Court should decline to grant certiorari because the decision of the South Carolina Supreme Court is consistent with the mandate of *Davis*, 489 U.S. 803, as confirmed by the following five reasons.

First, *Davis* provided states with two options for eliminating discriminatory taxation of federal and state

retirement benefits. A state could tax federal and state retirees alike, or it could tax neither. *Davis*, 489 U.S. at 818. South Carolina chose to tax federal and state retirees alike by eliminating the full tax exemption that was previously applicable only to state retirees. In this case, Petitioners are attempting to write into *Davis* the additional condition that a state is prohibited from increasing the retirement benefits of its own retirees at the same time that it chooses to tax equally state and federal retirees. Such a condition does not appear in *Davis*. *See Ward*, 590 S.E.2d at 32 ("[T]he doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income."); *Ragsdale*, 895 P.2d at 1353 n.11 ("*Davis* does not hold or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired. . . . What is prohibited by *Davis* is taxation discrimination 'on account of the source of the compensation' that is not 'directly related to, and justified by, 'significant differences between the two classes.'") (quoting *Davis*).

A limitation on a state's ability to alter its retirement benefits would be incompatible with the Tenth Amendment to the United States Constitution. *See New York v. United States*, 505 U.S. 144, 156 (1992) ("If a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States; if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress."). The power to compensate state employees and retirees is obviously not a power the Constitution has

conferred on Congress; therefore, it is a power reserved to the States by the Tenth Amendment. Accordingly, as long as federal and state retirees are taxed in the same manner, there is nothing preventing a state from increasing the benefits of its own retirees. *See Ward*, 590 S.E.2d at 32 ("As long as federal and state retirees are taxed equally, any restriction on this authority would violate the Tenth Amendment."); *Ragsdale*, 895 P.2d at 1357 ("The state should be free to compensate its employees with its eyes open to the tax burdens that it places on them. We do not believe that the Supreme Court of the United States would assert that the principle of intergovernmental tax immunity deprives the state of its sovereignty to fix the level of its employees' compensation. . . . ").[5]

Second, the state supreme court's decision is consistent with *Davis* because the intergovernmental tax immunity doctrine, as codified in 4 U.S.C. § 111, is concerned with taxation and not compensation. The statute provides in relevant part: "The United States consents to the *taxation* of pay or compensation for personal service as an

[5] Petitioners have previously argued that states are free to raise the benefits of their retirees as long as such increases do not coincide with the elimination of a tax exemption. There is simply no support for such an argument. If the South Carolina General Assembly had raised the retirement benefits of state retirees one year, one month, or one week after eliminating state retirees' tax exemption, there would have been no constitutional violation under Petitioners' theory. However, Petitioners have posited that because the increase occurred at the same time as the elimination of the tax exemption, there is a constitutional violation. Petitioners have yet to articulate a single persuasive reason why a state (or even the federal government) is constitutionally prohibited from raising the benefits of its retirees at any time, including at the same time as eliminating a tax exemption.

officer or employee of the United States . . . if the *taxation* does not discriminate against the officer or employee because of the source of the pay or compensation." 4 U.S.C. § 111(a) (emphasis added). *Davis* confirms that 4 U.S.C. § 111 is concerned with the equality of treatment in the *taxation* of federal and state retirees.[6] Neither 4 U.S.C. § 111 nor *Davis* concerns itself with the compensation that states pay their employees or retirees. By contrast, Petitioners argue, in effect, that *Davis* mandates equality not only of taxation, but also of take-home income. Thus, despite the fact that federal and state retirees in South Carolina pay taxes at precisely the same rates and with the same exemptions, Petitioners still insist that there is inequality of treatment because the take-home income of

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[6] *See Davis*, 489 U.S. at 810 ("[4 U.S.C. § 111] waives whatever immunity past and present federal employees would otherwise enjoy from state *taxation* of salaries, retirement benefits, and other forms of compensation . . . except to the extent that such *taxation* discriminates on account of the source of the compensation.") (emphasis added); *id.* at 812 ("[C]onsiderations of fairness demanded equal *tax* treatment for state and federal employees. . . . ") (emphasis added); *id.* ("[4 U.S.C. § 111] expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state *taxes*.") (emphasis added); *id.* ("The final clause of the section [4 U.S.C. § 111] contains an exception for state *taxes* that discriminate against federal employees on the basis of the source of their compensation.") (emphasis added); *id.* at 818 ("[A]ppellant's claim could be resolved either by extending the *tax* exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees.") (emphasis added).

Subsequent interpretation of *Davis* by this Court has also focused on taxation: "In *Davis* . . . , we held that a State violates the constitutional doctrine of intergovernmental tax immunity when it *taxes* retirement benefits paid by the Federal Government but exempts from *taxation* all retirement benefits paid by the State or its political subdivisions." *Harper*, 509 U.S. at 89 (emphasis added).

state retirees is higher as a result of Act 189's increase in state retirement benefits. *Davis*, though, prohibits only discriminatory taxation; it does not prohibit differences in take-home income between state and federal retirees.

Third, that the South Carolina Supreme Court has properly applied *Davis*'s holding is additionally and indisputably confirmed by the fact that Petitioners would have been in no different position had state retirees not received a retirement benefits increase. As discussed earlier, *Davis* held states could cure the infirmity of discriminatory taxation "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Petitioners impliedly concede that had South Carolina just eliminated the tax exemption for retired state and local government employees, the State's actions would not have violated 4 U.S.C. § 111. (*See* Petition for a Writ of Certiorari, pp. 6-7). Petitioners' problem with Act 189 is that they believe South Carolina took "a third approach not warranted by *Davis*," by repealing the tax exemption for state retirement benefits, but simultaneously increasing the benefits for state retirees by 7%. (*See* Brief of Appellants [Petitioners], p. 8). In other words, under Petitioners' view, had Act 189 just eliminated state retirees' tax exemption, but not taken the additional step of raising state retirees' benefits, Act 189 would have been consistent with 4 U.S.C. § 111. *The problem with Petitioners' position is that there is absolutely no difference in Petitioners' state taxes under the "constitutional" version of Act 189 they argue South Carolina should have adopted as opposed to the purportedly "unconstitutional" version of Act 189 South Carolina actually enacted.* Petitioners would

not have paid a penny less in state taxes had South Carolina simply eliminated state retirees' tax exemption without also increasing their retirement benefits. Petitioners argue that the Court should look to the "practical impact" of Act 189. The practical impact of Act 189 is unmistakable: Petitioners are subject to the same taxation as state retirees, and Petitioners are paying exactly the same amount of taxes they would have paid had Act 189 not included a retirement benefits increase for state retirees.

Fourth, that the South Carolina Supreme Court's decision comports with *Davis* is also buttressed by the fact that *Davis* envisioned and impliedly approved the possibility of a state increasing the compensation of its employees or retirees to make up for assessed taxes. In arguing that Michigan's exemption of taxation of state retirees should be upheld, the dissent in *Davis* maintained that it was "peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." *Davis*, 489 U.S. at 824 (Stevens, J., dissenting). The *Davis* majority, in responding to the dissent, did not dispute *whether* a state may through increased compensation make up for assessed taxes, but *how* a state may do so. The majority implicitly recognized that states may increase salaries or benefits of their employees as long as they do not do so "at the expense of the federal treasury":

> We also take issue with the dissent's assertion that "it is peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." In order to provide the same after-tax benefits to all

> retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

Davis, 489 U.S. at 815 n.4 (internal citation omitted).

Thus, this Court made clear that "the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar" is that which "reduce[s] the State's employment costs at the expense of the federal treasury. . . . " *Id.*[7] By granting a tax exemption rather than increasing the salaries or benefits of state employees, a state may, in effect, be cheating the federal government. To the contrary, South Carolina's Act 189 is not "the type of discriminatory legislation that the

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[7] *See Ward*, 590 S.E.2d at 33 ("The Supreme Court implicitly recognized [in *Davis*] that a state's response to the Court's decision could be to increase compensation to state retirees to offset what those retirees lost in benefits as a result of being taxed."); *Almeter*, 2000 WL 1687589 at *2 ("In *Davis*, both the majority and minority opinions recognized that a state's response to the Court's holding might be exactly what plaintiffs now claim was the response of Virginia's General Assembly; that is, to pay extra money to state retirees to make up for what those retirees lost as a result of being taxed.").

doctrine of intergovernmental tax immunity is intended to bar" because it does not "reduce the State's employment costs at the expense of the federal treasury." *Id.* Rather, South Carolina has voluntarily *increased* its employment costs, while at the same time *bolstering* the federal treasury. Act 189 results in state retirees having to pay more federal income tax because they have to pay such tax on higher income levels (as a result of the 7% increase in state retirement income). As the South Carolina Supreme Court recognized: "The General Assembly's increase in retirement actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." *See Ward*, 590 S.E.2d at 33. Accordingly, Act 189 is consistent with the guidance in *Davis*.

Finally, even if Petitioners' "tax rebate" theory – that South Carolina has simply recast the tax as a benefit increase for state retirees – were legally viable under *Davis*, it would fail factually in this case. The South Carolina Supreme Court made the explicit factual determination that there was not a direct correlation between the increase in retirement benefits and the state retirees' new state tax obligations:

> [W]e find no direct correlation between state retirees' state tax obligations and the amount of increased retirement benefits. All eligible state retirees receive the 7% increase in retirement benefits. Act 189 resulted in an increase in compensation for state retirees, and was not a dollar for dollar offset.

Ward, 590 S.E.2d at 33. There was no direct correlation between the retirement benefits increase and state retirees' new tax obligations because Act 189 conferred a 7% retirement benefits increase to all South Carolina retirees

regardless of the individual retiree's tax liability. The tax liability of many state retirees was zero, while that of many others was between zero and 7%. *See* S.C. Code Ann. § 12-6-510 & 12-6-1170 (Supp. 2003). For example, a state retiree who had previously earned $2,000 in retirement income annually would, after the enactment of Act 189, receive a 7% increase in benefits (for a total benefits amount of $2,140), yet the retiree would not pay *any* additional taxes. Thus, the South Carolina Supreme Court's finding – that there is no direct correlation between the increase in benefits and the increase in taxation – is well-supported by the record. This Court should defer to the state court's factual findings. *See Hernandez v. New York*, 500 U.S. 352, 366 (1991) (plurality opinion) (Court defers to state court findings of fact absent "exceptional circumstances"); 22 James Wm. Moore, *Moore's Federal Practice* § 406.05[4] (3d ed. 2002) ("An issue does not become any less factual simply because its 'resolution is dispositive of the ultimate constitutional question.'") (quoting *Hernandez*, 500 U.S. at 366).[8] In light of the state supreme court's factual determination, Petitioners' "tax rebate" theory cannot succeed, and certiorari should be denied.

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[8] While Petitioners acknowledge that the South Carolina Supreme Court made a factual finding in this regard, they nevertheless attempt to dispute it. (*See* Petition for a Writ of Certiorari, p. 17) ("[A]lthough the court found that the benefit increase did not provide dollar-for-dollar compensation for the increased tax burden, the record demonstrated that the correlation was very high."). Petitioners have not offered compelling reasons for this Court to ignore the state court's findings. *See* Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings. . . .").

Thus, the foregoing reasons demonstrate that the South Carolina Supreme Court's decision in this case is fully consistent with 4 U.S.C. § 111 and *Davis*.[9]

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[9] Unable to offer any persuasive arguments based on *Davis* or any other decision of this Court discussing the intergovernmental tax immunity doctrine, Petitioners resort to reliance on a Commerce Clause case, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994). While there may be broad conceptual similarities between intergovernmental tax immunity and Commerce Clause cases, at the level of application, *West Lynn Creamery* is of no assistance here. As an initial matter, *West Lynn Creamery* recognized that the Commerce Clause "vests Congress with ample power to enact legislation providing for the regulation of prices paid to farmers for their products" and that the Commerce Clause "limits the power of the Commonwealth of Massachusetts to adopt regulations that discriminate against interstate commerce." *Id.* at 192. By contrast, because of the Tenth Amendment, there is not an analogous limitation on the power of the states to set the compensation of their employees or retirees. Additionally, *West Lynn Creamery* is factually distinguishable because in that case, a Massachusetts pricing order imposed an assessment on all fluid milk sold by dealers to Massachusetts retailers, and the "entire assessment" was "distributed to Massachusetts dairy farmers." *Id.* at 188. Here, there has been no allegation, much less a showing, that the "entire assessment" of state income taxes of federal retirees has been distributed to state retirees. Further, in *West Lynn Creamery*, "[e]ach Massachusetts producer receive[d] a share of the total fund equal to his proportionate contribution to the State's total production of raw milk." *Id.* at 191. Unlike the Massachusetts producers in *West Lynn Creamery*, South Carolina state retirees have not received under Act 189 increased retirement benefits proportionate to their tax contributions; rather, all state retirees have received a 7% retirement benefits increase, regardless of their tax liability. Finally, unlike the out-of-state producers in *West Lynn Creamery* who did not receive the benefits of assessments paid, in this case, Petitioners receive the benefits of the income taxes they pay to South Carolina: Petitioners live (or have lived) in South Carolina and benefit from the state's governmental services and facilities. In sum, *West Lynn Creamery* is easily distinguishable and of no assistance to Petitioners.

II. NO TRUE CONFLICT EXISTS AMONG STATE COURTS CONSIDERING LEGISLATIVE RESPONSES TO *DAVIS V. MICHIGAN*.

Petitioners argue that the Court should grant the petition for writ of certiorari to address "the conflict among state courts created by state legislatures' attempts to overhaul state taxation provisions that are unconstitutional under this Court's decision in *Davis*." More particularly, Petitioners assert that "two state supreme courts [in *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762 (Mont. 1993) and *Vogl v. Department of Revenue*, 960 P.2d 373 (Or. 1998)] have struck down state laws that repeal a discriminatory tax exemption for state retirement benefits while simultaneously increasing the benefits paid to state retirees," whereas two other cases (the current one and *Almeter*) have found that "there is no constitutional problem under *Davis* and the intergovernmental tax immunity doctrine. . . . " (Petition for a Writ of Certiorari, pp. 10, 16). "There is," Petitioners urge, "a square and fundamental conflict between *Ward* and *Almeter*, on the one hand, and *Sheehy* and *Vogl*, on the other." (*Id.*, p. 16). Unfortunately for Petitioners, their argument is rebutted by review of the cases they claim are in conflict.

An analysis of the relevant decisions makes manifest that there is not a true conflict among them. Any differences between these decisions is attributable to the significantly different legislative schemes they address. Cases like the current one – wherein states have increased the benefits of all of their state retirees regardless of domicile and have not mathematically correlated the amount of the increase to the reduction in state taxes – have held that the intergovernmental tax immunity doctrine is not violated. *Ward*, 590 S.E.2d 30; *Ragsdale*,

895 P.2d 1348; *Almeter*, 2000 WL 1687589. By contrast, the cases that have found violations of 4 U.S.C. § 111 have been those wherein states have increased only the benefits of in-state state retirees or have mathematically correlated the increase in benefits to the particular retiree's increase in taxes. *Sheehy*, 864 P.2d 762; *Vogl*, 960 P.2d 373. As explained in greater detail below, the first category of cases is obviously factually distinguishable from the latter.

In *Ragsdale*, the Oregon Supreme Court considered whether the Oregon legislature's response to *Davis* violated the intergovernmental tax immunity doctrine. After the *Davis* decision was issued, the Oregon legislature repealed the tax exemption that it had previously granted on state retirement benefits. The legislature also increased state retirement benefits based on an employee's years of service, but "there [was] no mathematical correlation between taxes and the benefits created. . . . " *Ragsdale*, 895 P.2d at 1350. Further, "every state retiree who qualifie[d] for benefits (based on years of service) . . . receive[d] the benefits, regardless of the state retiree's residency." *Id.* at 1356. Considering this legislative scheme, the Oregon Supreme Court ruled that the legislation did not violate the intergovernmental tax immunity doctrine and upheld the position that "*Davis* does not hold, or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the [income tax] exemption." *Id.* Among the bases for the Oregon Supreme Court's decision was that there was "no correlation . . . between state retirees' state tax obligations and the amount of increased [state] retirement benefits." *Id.* at 1354. Like the statute in *Ragsdale*, there is no correlation under South Carolina's Act 189

between the state retirees' state tax obligations and the amount of increased retirement benefits.

Similarly, in *Almeter*, 2000 WL 1687589, federal retirees sought a declaration that a 3% increase in retirement benefits for Virginia state retirees was violative of the intergovernmental tax immunity doctrine inasmuch as the increase amounted to a "Tax Rebate" that gave "state retirees the same benefits they had before *Davis*." *Id.* at *1. The *Almeter* court rejected the federal retirees' claims, finding that the Virginia legislation was consistent with *Davis*, which "took no issue with a state's ability to lawfully increase the benefits paid to state retirees to offset the effect of the Court's holding. . . . " *Id.* at *2. South Carolina's Act 189, like the legislative scheme upheld in *Almeter*, also enacted a flat percentage retirement benefits increase for all state retirees.

Petitioners assert that *Ward*, *Ragsdale*, and *Almeter* are in conflict with *Vogl* and *Sheehy*. While *Vogl* and *Sheehy* found the statutes under review to violate the intergovernmental tax immunity doctrine, these cases do not present a true conflict because they considered very different legislative schemes. In *Vogl*, the same court that had decided *Ragsdale* three years earlier considered the constitutionality of a 1995 statute that increased retirement benefits to compensate for damages suffered by state retirees as a result of their benefits being subject to state personal income taxes. *Vogl* held that the 1995 statute violated the intergovernmental tax immunity doctrine; however, in reaching this conclusion, the Oregon Supreme Court expressly preserved its prior holding and analysis in *Ragsdale*: "We emphasize that our holding necessarily is confined to the 1995 statute. We do not overrule *Ragsdale*

or its analysis of the 1991 law." *Vogl*, 960 P.2d at 383. The *Vogl* court found that

> unlike the flat percentages employed by the 1991 statute [*i.e.*, the statute considered in *Ragsdale*], the 1995 statute increases benefits by way of a formula that is fairly closely matched to the task of replacing [state retirement] income that will be lost to taxes.

Vogl, 960 P.2d at 379. Moreover, the 1995 statute itself expressly announced that the increase was not merely a retirement benefit, but was compensation for damages:

> [T]he 1995 statute expressly announces that the increase is paid "in compensation for damages suffered by members of [Public Employees Retirement System] . . . by reason of subjecting [PERS] benefits . . . to Oregon personal income taxation" and is intended as "full, complete and final payment of any claim of a member of the system . . . arising out of the taxation of those benefits."

Vogl, 960 P.2d at 380 (quoting the 1995 statute). Thus, the statute under challenge in *Vogl* is clearly distinguishable from that reviewed in *Ragsdale* and the statute that is the subject of the current case. Unlike the 1995 statute in dispute in *Vogl*, South Carolina's Act 189 did not directly tie the increase in retirement benefits to the additional taxes state retirees had to pay; rather, Act 189 imposed a flat 7% increase for all state retirees, regardless of their new tax liability, and even provided the 7% increase to state retirees who had little or zero tax liability. Additionally, there was no legislative intent expressed in Act 189 to the effect that the increase in benefits was compensation

for damages. Therefore, *Vogl* cannot properly be compared to this case.

Petitioners also erroneously contend that the current case is in conflict with the Montana Supreme Court's decision in *Sheehy*, 864 P.2d 762. *Sheehy* involved a statute markedly different than South Carolina's Act 189. The statute in *Sheehy* granted to "state retirees who [were] Montana residents, and who . . . were to be taxed in response to *Davis*, an annual retirement adjustment payment." *Sheehy*, 864 P.2d at 764. The Montana court found the adjustment to violate *Davis* because it was "provided not to all state retirees, but only to state retirees who are Montana residents." *Id.* at 769. "It is clear that the adjustment is not an actual and legitimate pension or retirement benefit. If it were a pension benefit, the State would have provided it to *all* of its retirees in recognition of their years of public service rather than just those living in Montana." *Id.* at 768 (emphasis in original). By contrast, South Carolina's increase in retirement benefits is not limited to state retirees living in South Carolina, but applies to all South Carolina retirees, regardless of their domicile. Moreover, South Carolina granted the retirement benefits increase not just to those who "were to be taxed in response to *Davis*," *see Sheehy*, 864 P.2d at 764, but even those who were not going to be taxed in response to *Davis*. As such, *Sheehy*, like *Vogl*, is easily distinguishable from the current case, and no true conflict between the states has been identified by Petitioners.

III. THE NATIONAL SIGNIFICANCE OF THE CURRENT CASE IS LIMITED.

Petitioners assert that this case is worthy of the Court's attention because it presents "an important and recurring question of federal law with respect to the intergovernmental tax immunity doctrine. . . . " Petitioners overstate the significance of the case as a decision by this Court would directly affect, at most, only two other jurisdictions throughout the country.

As Petitioners have noted, only some seven states are in the category of those that, in response to *Davis*, eliminated a tax exemption for state retirement benefits and increased the retirement benefits of state retirees. (*See* Petition for a Writ of Certiorari, p. 7 & n.4).[10] Of these seven states, judicial resolution has already and finally been reached in four of them – Oregon (*Ragsdale & Vogl*), Virginia (*Almeter*), Montana (*Sheehy*), and South Carolina (*Ward*) – and a settlement has been reached in the challenge brought in North Carolina. A ruling by this Court would thus potentially have precedential value for only two remaining cases. Therefore, the future impact of the current case is too attenuated to warrant this Court's consideration.

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[10] Twenty seven states were not affected by *Davis* because they did not tax federal and state retirees differently. Of the twenty three states that were impacted by *Davis*, approximately a dozen granted tax exemptions to federal retirees like state retirees. (Petition for a Writ of Certiorari, p. 6 n.2). Moreover, a few other states withdrew the tax exemption from state retirees. (*Id.*, pp. 6-7 n.3). Finally, approximately seven states taxed federal and state retirees and also increased the retirement benefits of state retirees. (*Id.*, p. 7 & n.4).

CONCLUSION

For all the foregoing reasons, the State of South Carolina respectfully requests that the Court deny the petition for writ of certiorari.

Respectfully submitted,

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IN THE

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually
and on behalf of all others
similarly situated,

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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SCHOLARLY AUTHORITY

Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167 (1997) 3

INTRODUCTION

South Carolina asserts that under the Tenth Amendment, it has an unfettered right to enact a statutory regime with the acknowledged purpose and effect of perpetuating unconstitutional discrimination in the taxation of federal employees. This holding, if permitted to stand, would make the intergovernmental tax immunity doctrine an empty formality—easily and openly evaded by any State committed to discriminating against federal employees. According to South Carolina, moreover, it has provided a "remedy" responsive to this Court's decision in *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989), by enacting facially non-discriminatory taxation *and* a subsidy with the purpose and effect of compensating state employees for paying the same taxes that federal employees pay. The South Carolina court's decision does not comport with *Davis* and cannot be reconciled with *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994), where this Court found unconstitutional a state's non-discriminatory taxation of in-state and out-of-state producers, because the state also paid a subsidy to in-state producers with discriminatory intent and effect.

The question whether a state can evade the non-discrimination mandate of the intergovernmental tax immunity doctrine (and of the dormant Commerce Clause) by enacting subsidies for state employees (and in-state businesses) is important and recurring. It applies both to state statutes enacted in response to *Davis* and to any state statutory scheme enacted with the purpose and effect of discriminating against federal employees or interstate commerce. Equally to the point, there is presently a conflict among state courts on the question whether states can remedy discrimination that violates the intergovernmental tax immunity doctrine by enacting a facially neutral tax code and a linked compensation increase, with South Carolina and Virginia taking the position that states can always do so and Montana and Oregon taking

the opposite view. Tens of thousands of federal retirees' benefits are affected, with 65,000 at stake in South Carolina alone; other States' statutory responses to *Davis* are subject to challenge. The conflict and confusion in the lower courts about the application of the Constitution's non-discrimination mandates where facially neutral tax laws are linked to compensating pay increases and subsidies is worthy of this Court's attention.[1]

ARGUMENT

THE DECISION BELOW BROADENS A CONFLICT ABOUT *DAVIS* v. *MICHIGAN DEPARTMENT OF TREASURY* AND PRESENTS AN IMPORTANT, RECURRING CONSTITUTIONAL QUESTION.

1.(a) South Carolina concedes that "the General Assembly increased state employees' retirement benefits to compensate for the increased income tax obligations resulting from Act 189. Pet. App. 3a; Pet. 17. South Carolina nonetheless contends, and its supreme court agreed, that this linkage has *no* constitutional significance. South Carolina bases its position on (i) an expansive reading of the Tenth Amendment as providing the State with an absolute right to set employee compensation, and (ii) a parsimonious reading of *Davis* as concerned only with state laws labeled "taxation" and not those setting "compensation." Pet. App. 4a.

The South Carolina court's analysis is fundamentally at odds with this Court's repeated instruction that a State's label does not control the application of the intergovernmental tax immunity doctrine. See *Jefferson County, Ala.* v. *Acker*, 527

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[1] South Carolina insinuates that there may be a statute of limitations question in this case (Opp. 1 & n.2), but that is untrue. The State moved to dismiss on this ground below; the circuit court rejected the motion, and the State neither filed a cross-appeal from that ruling nor defended the circuit court's decision on that ground.

U.S. 423, 439 (1999) ("[t]he practical impact, not the State's name tag," determines whether a provision "fits within the Public Salary Tax Act's allowance"); *City of Detroit* v. *Murray Corp. of Am.*, 355 U.S. 489, 492 (1958) ("in determining whether the[] tax[] violate[s] the Government's constitutional immunity we must look through form and behind labels to substance."). Here, it is undisputed that in "substance," Act 189 is designed to allow South Carolina's retired employees to retain the benefit of the State's unconstitutional tax treatment of federal retirees. The decision under review directly presents the question whether the State's compensation decisions are immune from judicial scrutiny under the intergovernmental tax immunity doctrine in this setting.[2]

(b) In opposing this Court's review, South Carolina wrongly characterizes *West Lynn Creamery* as irrelevant. Opp. 19 n.9. In fact, this Court has expressly stated that the dormant commerce clause is "conceptually similar" to the intergovernmental tax immunity doctrine, 512 U.S. at 200 n.17, making plain the analogy between *West Lynn Creamery*'s linkage of premium payments and subsidies and South Carolina's linkage of its exemption repeal and retiree benefits increase. Like South Carolina, the respondent in *West Lynn Creamery* argued that because both components of its program—the subsidy and the nondiscriminatory tax—

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[2] South Carolina says that petitioners argue "that states are free to raise the benefits of their retirees as long as those increases do not coincide with the elimination of a tax exemption," Opp. 12 n.5, but they cite nothing to support this untrue statement. Petitioners have consistently argued that the State cannot increase retiree compensation with the intent and effect of compensating retirees for the loss of a discriminatory exemption. The simultaneity of a state's repeal of a discriminatory taxation scheme and enactment of a compensating benefit is clear evidence of linkage, *see* Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167, 2174 (1997); here the State's purpose to perpetuate past discrimination was conceded.

were individually valid, the program as a whole was valid. *Id.* at 198. This Court, however, made clear that it is error to "assum[e] that the constitutionality of [a state tax and benefit scheme] follows logically from the constitutionality of its component parts." *Id.* at 199.

The State utterly fails to distinguish *West Lynn Creamery*. It first resorts to the Tenth Amendment, Opp. 19 n.9, and contends that the federal government has no delegated power to interfere with how it compensates its employees. This argument is wrong,[3] and it also fails to distinguish the intergovernmental tax immunity doctrine from the dormant Commerce Clause. The State has the power to compensate its employees and subsidize its businesses, so long as it does not do so with the purpose and effect of discriminating against federal employees and out-of-state businesses. Thus, where, as here, the State's increase in retirees' "compensation" is in substance a discriminatory tax rebate, the State's power is circumscribed by the intergovernmental tax immunity doctrine. The South Carolina court's erroneous application of the Tenth Amendment in this case eviscerates the protections of the doctrine and leaves the State free to perpetuate discrimination against federal employees.

Nor is *West Lynn Creamery* distinguishable on the basis of the purportedly greater linkage between the nondiscriminatory tax and the compensating payment in that case. Initially, South Carolina's contention—that Act 189 differs from the scheme in *West Lynn Creamery* because individual state retirees' benefit increases are not always identical to their individual increased tax liabilities, Opp. 19 n.9—is wrong. As set forth in the Petition (17-18, 27), the State enacted a benefit increase that compensated individual

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[3] The Tenth Amendment does not preclude federal regulation of the compensation of State employees. *See, e.g., Garcia* v. *San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985) (subjecting State compensation of employees to the Fair Labor Standards Act).

retirees as closely as possible for the loss of the unconstitutional tax preference. In addition, *West Lynn Creamery* turned on the intertwined nature of the tax and the subsidy and the scheme's discriminatory purpose and effect, declining "to analyze separately two parts of an integrated regulation." 512 U.S. at 201. The court below, in significant contrast, treated the intertwined provisions of Act 189 as separate measures and thus constitutional *as a matter of law*.[4]

(c) South Carolina characterizes petitioners' reading of *Davis* as one mandating equality of take-home pay for federal and state government retirees. Opp. 13-14. This is a straw man. Petitioners freely acknowledge the State's authority to set employees' compensation, but that authority is limited by the Constitution which forbids States to perpetuate an unconstitutional tax preference for state retirees.

Moreover, it is unknown whether South Carolina's federal retirees would pay the same taxes they now pay had the State complied with *Davis*. The alternative remedies this Court established in *Davis* achieve their remedial effect only if States make the hard political choice of giving up tax revenues from federal retirees or increasing the tax liability of state retirees. Pet. 19-20.

> [W]hen a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax

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[4] South Carolina also makes a puzzling reference to the benefits federal retirees may receive by residing in and paying income tax to the State to distinguish this case and *West Lynn Creamery*. Opp. 19 n.9. The Court, however, gave no indication that the benefits out-of-state milk producers received because they paid the State's assessment (*e.g.*, the right to do business in the State) were relevant to whether the Massachusetts scheme was constitutional. Any benefits resulting from the retirees' residence in South Carolina are similarly irrelevant to the constitutional analysis here.

> has been mollified by the subsidy. [*W. Lynn Creamery*, 512 U.S. at 200.]

The State cannot say that federal retirees would have paid the same state taxes absent its constitutional violation, because it does not know what result would have emerged from a political process responsive to the Court's mandate in *Davis*.

(d) South Carolina also defends its actions as authorized by a footnote in *Davis*, citing 489 U.S. at 815 n.4. Opp. 15-16. Initially, the question whether the State could perpetuate its discriminatory treatment by compensating state retirees for increased tax liabilities was not, of course, before the Court. Second, the footnote was not addressed to the State's power to compensate employees, but to the dissent's argument that "it [was] peculiarly inappropriate to focus solely on the treatment of state governmental employees" (rather than all state citizens) in finding discrimination against federal employees. 489 U.S. at 824 (Stevens, J., dissenting). Last, if South Carolina's aggressive reading of the *Davis* footnote were correct, a State could increase a retiree's benefits in an amount identical to the retiree's additional taxes, nullifying *Davis*' mandate of equal treatment. Oregon and Montana have already *rejected* any such reading of *Davis*.

This Court should grant review of South Carolina's announcement of a rule of law authorizing the facile evasion of the intergovernmental tax immunity doctrine set forth in *Davis* and the State's perpetuation of its discriminatory tax treatment of federal employees and retirees.

2. South Carolina is manifestly wrong in stating that the decision below does not conflict with the decisions in *Sheehy* v. *Public Employees Retirement Division*, 864 P.2d 762 (Mont. 1993), and *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998). Opp. 20. The South Carolina Supreme Court held that the State's increase in its employees' compensation can never be an unconstitutional tax rebate because the State has a Tenth Amendment right to determine state employees'

compensation and any restriction on that compensation authority would "violate[] the Tenth Amendment" and impair "state sovereignty." Pet. App. 3a-4a. This is true, the court opined, "even if the state's purpose is to compensate its employees for the loss of the income tax exemption." *Id.* at 5a.

Sheehy and *Vogl* reject South Carolina's determination that a state's compensation decisions are immune from constitutional scrutiny. In both cases, the state supreme courts held that the States' repeal of the state employees' tax exemptions and the increases in state employees' retirement benefits were linked; that the linkage was "intended to make up, in part for that [tax] equalization"; and that "the adjustment is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law." *Sheehy*, 864 P.2d at 768. See also *Vogl*, 960 P.2d at 379, 380 (a benefits increase intended and designed to "'make up' for lost net income" is in "substance" an unconstitutional tax rebate).

South Carolina tries to argue that the different results in these cases can be explained by the differences in the statutory schemes, but this is clearly incorrect. First, the holding below is that a state compensation increase can *never* violate the intergovernmental tax immunity doctrine because the State has a Tenth Amendment right to make these decisions unrestricted by other constitutional provisions. *Sheehy* and *Vogl* plainly conflict with that holding.

Second, South Carolina cites differences between the coverage and amount of the increases in its scheme and in the schemes enacted by Montana and Oregon. Opp. 22-24. It is South Carolina's legal holding and not these minor differences that explains the differing outcomes in these States. Moreover, the critical difference South Carolina relies on—the alleged lack of mathematical correlation between the increase in taxes and the increase in compensation—is wrong. In *Vogl*, as here, the State granted all state retirees an increase in compensation based on the maximum state tax rate; thus,

the tax and compensation increases were as closely correlated as possible, but not perfectly correlated (indeed, the latter is virtually impossible to achieve). See 960 P.2d at 380 (explaining that the 1995 statute "does not purport to offset, dollar for dollar, the amount lost to the exemption repeal in every individual case"); Pet. 17-18 (demonstrating that although not dollar-for-dollar, South Carolina endeavored to match the tax and compensation increases as best it could).

Much more critically, in *Sheehy* and *Vogl*, the coverage (the group of state employees receiving the compensation increases) and the amount of the state-awarded increases are simply *evidence* that the respective State's intent and effect was to perpetuate discrimination against federal employees. Such evidence was particularly critical in Montana where the State did not acknowledge that its intent was to compensate state employees for the loss of their discriminatorily favorable tax treatment. See *Sheehy*, 864 P.2d at 768 (amassing pieces of evidence demonstrating legislature's discriminatory intent). Here, as was true in Oregon (see *Vogl*, 960 P.2d at 380), the State's intent to perpetuate its discrimination in favor of state employees was open and acknowledged, and the rebate achieved that intent. See Pet. App. 3a (acknowledging that South Carolina increased retirement benefits to compensate state retirees for the increased income tax obligations imposed in Act 189); see also Pet. 17 (quoting lower court decisions). The minor differences among the state schemes cannot explain the diametrically opposed conclusions that the state courts reached on the constitutionality of linked tax and compensation increases in response to *Davis*.[5] Had the South

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[5] Thus, South Carolina is simply wrong when it says that petitioners are attacking the lower court's factual finding of no "dollar-for-dollar" correlation, Opp. 21. Dollar-for-dollar correlation is not required; and, like Oregon in *Vogl*, the State here sought to compensate its retirees as closely as possible for the tax increases. Most critically, correlation is evidence of the State's intent and design to perpetuate discrimination,

Carolina scheme been reviewed in Oregon or Montana, it would have been struck down as unconstitutional.

3. Despite South Carolina's characterization, Opp. 25, its highest court's evisceration of the intergovernmental tax immunity doctrine by announcing the State's absolute Tenth Amendment right to set employee compensation is hardly inconsequential. This case is critically important because it poses both the specific question of the enforcement of the Court's mandate in *Davis*—a question that has now generated a conflict among the states—and the more general question of the meaning of the federal Constitution's prohibition of state discrimination in taxation of federal employees and of interstate commerce.

With respect to *Davis* specifically, this case alone involves approximately 65,000 federal retirees. Thousands of other federal retirees are involved in litigation in Utah and potentially in Arizona. The constitutional treatment of tens of thousands of retired federal employees is important by itself; here that importance is compounded by several additional factors.

First, South Carolina's decision—that it has an absolute right under the Tenth Amendment simultaneously to increase taxes and compensate state retirees and employees for such tax increases—does not apply only to the specific linked scheme at issue here. Under the analysis in this decision, South Carolina and any state seeking to provide favored tax treatment to its own employees may use this technique to avoid the command of the intergovernmental tax immunity

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which were confirmed here by the State's admission and the court's statements (cited at Pet. 17-18).

Nor do we advance a strict rule of simultaneity, as the State suggests. Opp. 12 n.5. While the simultaneous enactment of both provisions of Act 189 is a powerful factor that contributes to finding a linkage between them—and thus calling for constitutional analysis of Act 189 as a whole—simultaneity is but one more piece of evidence, *see* n.2 *supra*.

doctrine in the future. See Pet. 25. And, as demonstrated in the Petition, the decision below is relevant to dormant Commerce Clause challenges to facially neutral state tax laws linked to subsidies of in-state industries.

Moreover, this case represents the remedial phase of the Court's decision in *Davis*. South Carolina has attempted to evade the Court's mandate by enacting linked statutes with the acknowledged purpose of perpetuating state retirees' favored status; other States have refused to allow similar attempts to circumvent the substantive impact of this Court's finding of discrimination in *Davis*. This case thus involves the enforcement of this Court's mandate uniformly among the states—a question whose importance transcends that of the merits of the individual case.

Whether assessed in terms of the number of federal retirees and employees affected now and in the future, or in terms of the importance of maintaining the integrity of the intergovernmental tax immunity doctrine or dormant Commerce Clause jurisprudence, or in terms of resolving a conflict among state courts about the constitutionality of linked tax and compensation/subsidy schemes, this case merits the Court's attention.

CONCLUSION

The petition for certiorari should be granted.

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IN THE

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually
and on behalf of all others
similarly situated

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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INTRODUCTION

In the Public Salary Tax Act, 4 U.S.C. § 111(a), the United States consented to state taxation of federal employees and retirees, but imposed the condition that the tax "not discriminate against the [federal] officer or employee because of the source of the pay or compensation." Enforcing this enactment of the intergovernmental tax immunity doctrine, this Court has held that a state may not exempt state employees' retiree benefits from state taxation without providing the same exemption to federal retirees. *Davis* v. *Mich. Dep't of Treasury*, 489 U.S. 803 (1989). South Carolina did not comply with *Davis*'s remedial mandate of equal treatment for federal retirees, but instead substituted an increase in state retiree benefits for its unlawful state retireee tax exemption; this linkage in this integrated measure intentionally perpetuated the State's discrimination against federal retirees.[1]

In an astonishing and inexplicable brief, the United States now takes a position wholly contrary to the interests of tens of thousands of federal retirees in this case and millions of federal employees and retirees in future cases. Based on a footnote in *Davis*, the United States argues that the intergovernmental tax immunity is an empty formalism that addresses a state's imposition of taxes in isolation from its tax subsidies. According to the United States, South Carolina's admitted linkage between taxing and spending is irrelevant—even where the integrated measure has the purpose and effect of preserving a state's discriminatory tax regime—so long as the federal treasury benefits from the state retirees' increased compensation. U.S. Br. 6-7.

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[1] The State's admitted purpose behind and the acknowledged effect of enacting Act 189 was "to provide that state retirees do not experience a tax increase." *See infra*, at 9-10.

Petitioner disagrees vehemently with the United States' contention that a state "cures" its unconstitutional discrimination by enacting a facially-neutral tax policy linked to a compensation increase with the avowed purpose and effect of perpetuating discrimination. But the United States' position makes it even more urgent that the petition be granted, because the continuing vitality of the intergovernmental tax immunity doctrine is now at stake. The United States' public position will have substantial influence in Utah and Arizona, where continuing litigation[2] addresses the constitutionality of their States' responses to *Davis*. See Reply 9. The United States' brief also provides States which responded to *Davis* by curing their past discrimination (by exempting federal retirees from taxation or subjecting state retirees to taxation) with a roadmap to restore discrimination and score political points with the important constituency of state retirees.

In this reply, accordingly, we show that the decision below—adopted by the United States—is entirely inconsistent with this Court's precedents. The United States wrongly asserts that *Davis* endorses a purely formalistic intergovernmental tax immunity doctrine that is principally concerned with impact on the federal treasury, rather than discrimination against federal employees and the federal government. And, the United States implausibly attempts to distinguish *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994)—holding unconstitutional a state's facially neutral tax because the state also paid a subsidy to in-state producers with discriminatory intent and effect—on the asserted ground that the directly analogous dormant commerce clause forbids discriminatory linkage but the intergovernmental tax immunity doctrine does not.

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[2] *See Thompson* v. *Utah State Tax Comm'n*, No. 20030506-SC (Utah, filed June 13, 2003); *Kerr* v. *Killian*, 84 P.3d 446 (Ariz. 2004), *petition for cert. filed sub nom. Moran* v. *Hibbs*, 72 U.S.L.W. 3702 (May 3, 2004) (No. 03-1495).

We also show that despite the United States' characterization of the decision below as fact-bound, in reality, state courts apply directly conflicting legal standards to claims arising under the intergovernmental tax immunity doctrine, based on their inconsistent interpretations of *Davis*—a conflict especially stark given South Carolina's Tenth Amendment holding. The need for this Court's review is now imperative in light of the importance of the issue (including the numerous federal civilian and military retirees affected), the United States' adoption of the position that the intergovernmental tax immunity doctrine may be facilely evaded, and the clear conflict among the states over the proper application of this Court's precedents.

ARGUMENT

I. THE DECISION CANNOT BE RECONCILED WITH *DAVIS* AND *WEST LYNN CREAMERY*.

A. The United States first argues that Act 189 fully complies with *Davis* "because it 'repealed the tax exemption for state retirement benefits.'" U.S. Br. 5. The Government reads *Davis* as "endors[ing]" its dissent's suggestion "that a State could simply increase benefits to state retirees in order to replace the invalidated tax exemption." *Id.* at 6. Thus, the United States concludes, "*Davis* forbids only discriminatory *taxation*; it does not purport to preclude States from benefiting their retirees in other ways." *Id.* at 7. The United States believes a state's response to *Davis* remedies a constitutional violation unless the state reduces its costs "'at the expense of the federal treasury'"—even if the state's purpose and effect perpetuate discrimination. *Id.* at 6-7.

This reading of *Davis*, based on a footnote in the decision, 489 U.S. at 815 n.4, adopts that of the South Carolina Supreme Court—*viz.*, that the intergovernmental tax immunity doctrine is *solely* about neutral taxation and that a constitutional violation can be cured by perpetuating the

discriminatory treatment of federal retirees using a different fiscal tool (a compensatory increase in benefits). This reading conflicts with the reading of several state courts and with this Court's holding in the analytically analogous area of the dormant commerce clause, as we show *infra*. Equally to the point, for several reasons, this is a profound misreading of *Davis* and the Public Salary Tax Act (which the United States never cites)—a misreading that has exceptional importance precisely because it is *the United States' interpretation* and will have influence in other litigation that will decide whether discrimination has been cured.

First, the United States' overreading of footnote four is inconsistent with the bulk of the *Davis* opinion; in fact, the United States' argument would have footnote 4 nullify the holding of the case. *Davis* consistently focuses on discrimination against federal officers. 489 U.S. at 808-09, 812-13, 816-18 (discussing discrimination against federal employees). And while noting that limiting interference with federal governmental function is important, *Davis* held that "it does not follow that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign cannot themselves receive the protection of the constitutional doctrine." *Id.* at 814. Thus, while the United States' position is that the intergovernmental tax immunity doctrine is violated only where there is harm to the federal treasury, "all precedent is to the contrary." *Id.* at 814-15 (citing cases). This court did not mandate equal treatment in *Davis* in order to benefit the federal treasury. The Court was focused on remedying discrimination. Moreover, in remedying discrimination against federal employees, this Court's precedents forbid States to do indirectly what they are forbidden to do directly. Indeed, the Court has expressly instructed that a State's labeling of a fiscal policy does not control the application of the intergovernmental tax immunity doctrine. *See Jefferson*

County, Ala. v. *Acker*, 527 U.S. 423, 439 (1999).[3] South Carolina's contrary ruling violates *Davis*' injunction that past discrimination must be remedied.

In any event, the function of footnote four in *Davis* is not (as the United States would have it) to describe the limits of the intergovernmental tax immunity doctrine but to respond to the *Davis* dissent's argument about the proper class of citizens to compare to federal employees for the purpose of finding unlawful discrimination. Compare 489 U.S. at 824 (Stevens, J., dissenting), with *id.* at 815 n.4. The *Davis* dissent thought it made little sense to compare federal and state employees because in lieu of exempting state retirees' income from taxation, a state could increase the compensation it paid its employees. In response, footnote four noted that a tax exemption and a compensation increase are not always fungible, because the latter "would result in higher federal income tax payments in some circumstances." This suggests only that a state, in considering whether *in the first instance* to provide a tax exemption or a benefit increase to state employees, could not simply substitute a compensation increase for an exemption because a fully compensatory increase would cost more. It cannot remotely be read to authorize the perpetuation of discrimination once discrimination is found.[4]

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[3] *See also Lawrence* v. *State Tax Comm'n*, 286 U.S. 276, 280 (1932) (with respect to the validity of a tax upon the federal government or its employees, "we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it"); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 288 (1977) (the constitutionality of a state tax does not turn on legislative phrasing because such "formalism merely obscures the question whether the tax produces a forbidden effect")

[4] Clearly, footnote 4 cannot be interpreted, as the United States says, to authorize States to maintain their discrimination by increasing compensation and benefiting the federal treasury. The Court expressly gave states the alternative of removing the exemption. Choosing that option actually *harms* the federal treasury by giving state retirees who

The United States says that a state's "previous[] violation [of] the doctrine of intergovernmental tax immunity" is not relevant to the state's power to increase state retirees' benefits. U.S. Br. 7. This is wrong. *Ab initio*, the State could set retirees' benefits as it saw fit; but once illegal discrimination was found, South Carolina was obligated to restore federal retirees to the position they would have occupied but for that unlawful discrimination. Pet. 20-21. Any other holding defies *Davis*' "mandate of equal treatment." 489 U.S. at 817. The remedial context is critically important, unless linkage is immaterial as a matter of law. And that is an important question that should only be decided by this Court.

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itemize a new federal tax deduction. Suppose a state increases the compensation it pays its retirees and simultaneously eliminates its pre-*Davis* state tax exemption; the retirees then owe the state additional taxes on the increased compensation. If, for example, taxpayers deducted their state tax payments pursuant to 26 U.S.C. § 164(a)(3) in calculating federal taxable income, the federal tax on the compensation increase is offset by the corresponding deduction for state taxes. *See* Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167, 2212-13 (1997) (providing similar example involving a business taxpayer). This illustrates that while there might be "some circumstances," *Davis*, 489 U.S. at 815 n.4, in which increased state retiree compensation yields increased federal tax payments, there are other circumstances in which the opposite is true. And the federal treasury surely receives less money under Act 189 than it would if South Carolina had done what footnote four describes: increase compensation in the amount of the lost discriminatory tax exemption *plus* the amount of additional federal taxation on the increased compensation. *See id.*

Accordingly, if the United States' interpretation of footnote four is correct, the boundaries of the intergovernmental tax immunity doctrine are delineated by the vicissitudes of federal tax policy, its interaction with state tax policy, and the aggregate effect of those policies on affected individual taxpayers. That is not what this Court intended in *Davis*. In fact, the intergovernmental tax immunity doctrine is directed at discrimination against federal employees and retirees—and discrimination is not cured by its indirect perpetuation.

B. The United States acknowledges (i) the "'conceptual similarity'" between intergovernmental tax immunity and the dormant commerce clause, U.S. Br. 7 (citing *West Lynn Creamery*, 512 U.S. at 200 n.17), and (ii) that under the latter, a facially neutral tax linked to a compensatory payment to in-state producers results in unconstitutional discrimination, *id.* at 8. It nonetheless contends that *West Lynn Creamery* does not apply to the analysis of similar fiscal schemes under the intergovernmental tax immunity doctrine.

In fact, however, these doctrines serve the related purposes of preventing discrimination that favors in-state interests as against those of other states (the dormant commerce clause) and those of the federal government (the intergovernmental tax immunity doctrine). As explained in the petition (19-20), a state's ordinary political process cannot be trusted to provide equal treatment for out-of-state businesses or federal retirees, if a state can avoid difficult political choices by enacting facially neutral tax policies and paying off state businesses and retirees for the loss of their favored status. See *Davis*, 489 U.S. at 817-18 (requiring states to make the difficult choice); *W. Lynn Creamery*, 512 U.S. at 200 & n.17. Applying *West Lynn Creamery*'s linkage analysis prevents this defect in the political process from yielding a state tax scheme that discriminates against federal retirees.

While the United States is correct that the dormant commerce clause does not apply to states when they act as general market participants, U.S. Br. 8-9, that point is irrelevant here. South Carolina was not acting as a market participant when it passed Act 189, compensating retirees for a lost tax exemption. While setting employment benefits generally is a proprietary function, Act 189 was intentionally linked to the state's amended tax regime and thus was clearly an exercise of governmental power. The linkage between the two renders the integrated enactment unconstitutional.

Accordingly, *West Lynn Creamery* is fully applicable in this setting. This Court held that "[t]he choice of

constitutional means—nondiscriminatory tax and local subsidy—cannot guarantee the constitutionality of the program as a whole." 512 U.S. at 201. Thus, the Court refused to "analyze separately two parts of an integrated regulation," *id.*, and found the linked scheme discriminatory. The decision below and the United States' brief are flatly inconsistent with *West Lynn Creamery*.

II. STATE COURTS ARE IN CONFLICT ABOUT THE RELEVANCE OF LINKAGE AND THE PROPER APPLICATION OF *DAVIS*.

The second part of the United States' brief contradicts the first: If, as the United States says, the intergovernmental tax immunity doctrine is a formal rule about taxation and courts never need to consider whether a benefits increase linked to an exemption repeal has perpetuated a discriminatory tax scheme, there is an inescapable conflict between the decision below and other decisions that have examined whether there is an unconstitutional linkage between a State's taxing and spending measures. Yet after rejecting the legal relevance of linkage, the United States dismisses this conflict among the state courts as attributable to the fact-bound details of the various linked state schemes. The United States cannot have it both ways. Linkage either is or is not legally relevant, and any fair reading of the decisions reveals that the states are in conflict on this fundamental point.

According to the United States, South Carolina did not reject linkage and say that a facially neutral tax law can never be an unconstitutional tax rebate. U.S. Br. 13. This is clearly wrong. The sweep of the decision is evident, holding that: "As long as federal and state retirees are taxed equally, any restriction on this authority [to increase state retirees' compensation] would violate the Tenth Amendment." App. 4a; *id.* at 3a (the Constitution "does not deprive a state of its sovereignty to establish the level of its employees' compensation *so long as the State does not discriminate in taxation*") (emphasis added). Under this rule, the tax rebate

schemes invalidated in *Sheehy* v. *Public Employees Retirement Division*, 864 P.2d 762, 768 (Mont. 1993), and *Vogl* v. *Department of Revenue*, 960 P.2d 373, 379 (Or. 1998), are constitutional because Montana and Oregon taxed federal and state retirees equally. The ruling below plainly conflicts with the analysis and outcomes in *Sheehy* and *Vogl*.

Indeed, not only *Sheehy* and *Vogl*, but also *Ragsdale* acknowledged that the intergovernmental tax immunity may be violated by providing a "partial tax rebate denominated otherwise" if the purpose and effect of the enactment are discriminatory. *Sheehy*, 864 P.2d at 768; *Vogl*, 960 P.2d at 379 ("in the world of intergovernmental tax immunity, substance does count"); *Ragsdale* v. *Dep't of Revenue*, 895 P.2d 1348, 1354 (Or. 1995). The critical point is that these courts have concluded that under a linked tax and compensation scheme with a discriminatory purpose and effect, the increased compensation is a *de facto* tax rebate, while South Carolina (like the United States) has adopted a test that requires only facially neutral taxation.[5]

South Carolina's analysis of *Sheehy* and *Vogl* was undertaken simply to shield its Tenth Amendment holding from review. As demonstrated in our petition (16-18), had the South Carolina court applied the *Sheehy/Vogl* test, it would have acknowledged that Act 189 is a disguised tax rebate. The State's intent to compensate state retirees for the loss of their discriminatorily favorable tax treatment was open and acknowledged. The state supreme court so found. See Pet. 17 (citing three state court decisions). It was admitted by the State's lawyers, see S.C. Mem., R. on Appeal at 172, *Ward* v. *South Carolina*, 590 S.E.2d 30 (filed May 13, 2003);

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[5] The United States dismisses *Almeter* v. *Virginia Department of Taxation*, No. LL-821-4, 2000 WL 1687589 (Va. Cir. Ct. Nov. 6, 2000) (rejecting the linkage analysis), as irrelevant to a conflict among "'state court[s] of last resort.'" U.S. Br. 11 n.2 (alteration in original). Because the Virginia Supreme Court and this Court declined review, however, *Almeter* is the current law of Virginia regarding compliance with *Davis*.

App. 3a. It was fully supported by all record evidence. See Whitlock Aff., R. on Appeal at 37-40 (Assistant Director of retirement system describing Act 189); 1989 Report of the S.C. Retirement Systems, *id.* at 76 (Director of retirement system explaining that "our retirees' benefit formulas were enhanced so as not to penalize retirees as a result of [Act 189's repeal of the tax exemption]"); Rainwater Dep. Exh. A, *id.* at 91 (describing calculations the state made in calibrating Act 189's benefits "to provide that state retirees do not experience a tax increase").[6]

Given the foregoing, South Carolina clearly did not follow the approach adopted in *Sheehy* and *Vogl*. Instead, it concluded that "[a]s long as federal and state retirees are taxed equally, any restriction in this [compensation] authority would violate the Tenth Amendment." App. 4a. This holding is wrong and merits review.

CONCLUSION

The petition for certiorari should be granted.

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[6] The United States makes much of Act 189's application to state retirees living outside of South Carolina, arguing that it distinguishes Act 189 from the acts found unconstitutional in other states. Of course, this fact does not distinguish *Vogl*; nor does it distinguish *Davis*, because undoubtedly there were Michigan state retirees who were no longer Michigan residents and thus did not benefit from Michigan's pre-*Davis* exemption. More importantly, the recited fact proves nothing here: Because South Carolina law *requires* uniform treatment of state retirees, *see Kennedy* v. *South Carolina Retirement System*, 549 S.E.2d 243, 250 (S.C. 2001), Act 189's benefit increase was as closely correlated as was legally possible to the increased tax liability resulting from the repeal of the discriminatory tax exemption, and deliberately so.

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No. 03-1304

In the Supreme Court of the United States

DORIS STIEGLITZ WARD, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, PETITIONERS

v.

STATE OF SOUTH CAROLINA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH CAROLINA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

In *Davis* v. *Michigan Department of the Treasury*, 489 U.S. 803 (1989), this Court held that exempting state, but not federal, retirement benefits from state income tax violates the intergovernmental tax immunity doctrine, codified at 4 U.S.C. 111, and instructed States with a discriminatory tax system to eliminate the tax benefits enjoyed by state retirees or extend the benefits to federal retirees as well. The question presented is whether South Carolina satisfied this Court's mandate in *Davis* by eliminating a discriminatory tax exemption and simultaneously increasing the retirement benefits of all state retirees by a fixed percentage.

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STATE OF SOUTH CAROLINA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH CAROLINA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States. The United States submits that the petition for a writ of certiorari should be denied. The decision below is consistent with this Court's precedents, and there is no conflict among the state appellate courts that have addressed the question presented.

STATEMENT

1. In 1989, this Court held in *Davis* v. *Michigan Department of the Treasury*, 489 U.S. 803 (1989), that States cannot discriminate against the United States

and its retired employees by taxing federal retirement benefits while exempting the benefits of state retirees from state income tax. Such a discriminatory taxing scheme violates "principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." *Id.* at 817. The Court declined, however, to require those States with discriminatory tax systems to abolish their exemptions for state retirees, observing that a violation of the intergovernmental tax immunity doctrine could be remedied either "by extending the tax exemption to retired federal employees * * * or by eliminating the exemption for retired state and local government employees." *Id.* at 818.

2. Prior to the decision in *Davis*, South Carolina exempted all state retirement benefits from the State's personal income tax, but exempted only the first $3000 of federal retirement income. Pet. App. 3a. In response to *Davis*, South Carolina passed Act 189, which repealed the exemption for state retirement benefits and required the taxation of both federal and state retirement income in excess of $3000. See Act 189, § 39, 1989 S.C. Acts 1436-1439. In part to compensate retired state employees for the resultant tax obligation, Act 189 also increased retirement benefits to all state employees by seven percent. *Id.* § 60, 1989 S.C. Acts 1484-1488; Pet. App. 3a. As a result, all state retirees, even those domiciled in other States who are unaffected by the change in South Carolina's tax law, receive additional benefits. *Ibid.*

Petitioners, retired federal employees, subsequently filed this action to challenge Act 189 as inconsistent with *Davis* and in violation of the intergovernmental tax immunity doctrine. Pet. App. 11a-12a. Petitioners alleged that, by simultaneously eliminating the state re-

tirees' tax exemption and increasing their benefits by seven percent, the State had granted "an unlawful 'tax rebate' to state retirees." *Id.* at 11a.

3. The South Carolina Court of Common Pleas upheld the constitutionality of Act 189. Pet. App. 10a-25a. The court reasoned that the South Carolina legislature had chosen "to tax federal and state retirees alike," and "*Davis* did not place any limitations on how a state could tax all retirees, as long as they were taxed in the same manner." *Id.* at 14a-15a. The court rejected petitioners' argument that the State had in fact given its retirees a discriminatory "tax rebate" by increasing their retirement benefits. *Id.* at 15a. That argument "confused the concepts of *taxation* and *take-home income*." *Ibid.* "Contrary to [petitioners'] premise," the court held, "*Davis* was not concerned with discriminatory state action in relation to take-home income, but rather with taxation." *Ibid.*

4. In a unanimous opinion, the Supreme Court of South Carolina affirmed. Pet. App. 1a-8a. In its view, "the doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income." *Id.* at 3a. Moreover, "in enacting Act 189, the General Assembly specifically followed the dictate of *Davis* by eliminating the tax exemption for both state and federal employees." *Id.* at 4a.

The court disagreed with petitioners' argument that Act 189 was discriminatory because it was motivated, in part, by the state legislature's desire to compensate for the increased tax burden on state retirees. Pet. App. 4a. The court reasoned that *Davis* did not "hold[ ], or otherwise impl[y], that states may only raise retirement benefits for its state's retirees if the pension

increase in no way serves to offset a prior tax exemption." *Ibid.* Rather, "*Davis* requires that the state *tax* federal and state retirees equally and does not concern itself with the manner in which a state chooses to *compensate* its retirees." *Id.* at 5a.

The court also rejected petitioners' argument that the additional benefits were effectively a "tax rebate." That argument was factually incorrect because there was "no direct correlation between state retirees' state tax obligations and the amount of increased retirement benefits." Pet. App. 6a. Act 189 did not establish a "dollar for dollar offset" of the additional tax burden and did not exempt the increased benefit from taxation. *Ibid.* It extended the benefit to all eligible retirees, including those domiciled outside of South Carolina who suffered no increased tax burden, and "actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." *Ibid.*

The South Carolina Supreme Court distinguished decisions of the Montana Supreme Court and Oregon Supreme Court invalidating state statutes that similarly repealed tax exemptions on state retirement benefits and increased the benefits received by state retirees. Pet. App. 6a-8a (citing *Sheehy* v. *Public Employees Ret. Div.*, 864 P.2d 762 (Mont. 1993); *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998)). In the court's view, those cases were factually distinguishable because they concerned meaningfully different tax schemes. Montana had not adopted a legitimate retirement benefit for all retirees but had instead provided additional benefits only for state retirees who were Montana residents. Act 189, by contrast, increased retirement benefits "to all state retirees" regardless of domicile. *Id.* at 7a. The invalidated Oregon statute was expressly intended to compensate state

retirees for "damages" from the loss of their tax exemption and had "mathematically correlated" the benefit increases "to replace the lost state retirement income," while Act 189 "did not tie the pension benefit increase, dollar for dollar, to the lost tax exemption" and was not "designed to compensate state retirees for damages." *Id.* at 7a-8a.

DISCUSSION

The South Carolina Supreme Court's decision is consistent with this Court's precedents, and state appellate courts uniformly acknowledge that a State may increase compensation to retired state employees without running afoul of the intergovernmental tax immunity doctrine. Further review by this Court is therefore not warranted.

I. The Decision Below Is Consistent With This Court's Precedents

Review is unnecessary because the South Carolina Supreme Court's decision is correct and consistent with this Court's precedents.

1. Act 189 fully complies with the mandate of *Davis*. This Court held in *Davis* that a State's exemption of the retirement benefits of state employees, while the analogous benefits of retired federal employees were taxed, violated the intergovernmental tax immunity doctrine. The Court explained that a State could remedy this violation *either* "by extending [any] tax exemption to retired federal employees (or to all retired employees), *or* by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Act 189 fulfilled this mandate because it "repealed the tax exemption for state retirement benefits, thereby rendering all federal and state retirement benefits in excess of $3000 taxable." Pet. App. 3a.

The State's simultaneous decision to increase retirement benefits generally to all state retirees is not inconsistent with *Davis*. Indeed, this Court suggested in *Davis* that increasing state retiree compensation would not violate the intergovernmental tax immunity doctrine. The Court was unmoved by the dissent's suggestion in *Davis* that a State could simply increase benefits to state retirees in order to replace the invalidated tax exemption. The Court implicitly endorsed such an approach as non-discriminatory and consistent with the purpose of the intergovernmental tax immunity doctrine, reasoning that "[i]n order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances." *Davis*, 489 U.S. at 815 n.4. In contrast, "[t]axes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar." *Ibid.*

Consistent with this analysis, Act 189 has no impermissibly discriminatory effect: "The General Assembly's increase in retirement actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." Pet. App. 6a. Act 189 ensures that the State is not artificially reducing "the state's employment cost at the

expense of the federal treasury" and accordingly remedies the unconstitutionally discriminatory tax.[1]

Petitioners suggest (Pet. 19) that a State's freedom to increase retirement benefits to its retirees is somehow diminished if the State has previously violated the doctrine of intergovernmental tax immunity by discriminating against federal retirees, but they offer no support for that proposition. *Davis* forbids only discriminatory *taxation*; it does not purport to preclude States from benefitting their retirees in other ways.

2. Contrary to petitioners' suggestion, the decision below does not conflict in any way with *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994), which held that a State could not charge both in-state and out-of-state milk producers a premium and then distribute the proceeds solely to in-state producers. *Id.* at 190-191. The Court reasoned that such a system violated the Commerce Clause because its "avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States." *Id.* at 194.

West Lynn does not assist petitioners. Although this Court's dormant Commerce Clause jurisprudence bears some "conceptual similarity," *West Lynn*, 512 U.S. at 200 n.17, to the field of intergovernmental taxation, there is a fundamental difference between the

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[1] The fact that Act 189 fails to provide a prospective benefit to the plaintiffs in no way reduces the extent to which it remedies the discriminatory and artificial subsidy problems identified in *Davis*. It has long been established that States can remedy unconstitutionally discriminatory taxes either by reducing the plaintiff's tax burden or by increasing the taxes of others similarly situated, *Davis*, 489 U.S. at 817-818; *Iowa-Des Moines Nat'l Bank* v. *Bennett*, 284 U.S. 239, 247 (1931), even though only the former directly benefits the plaintiff.

protections afforded by the Commerce Clause and those provided by the doctrine of intergovernmental tax immunity that renders *West Lynn* inapposite. The Commerce Clause generally prohibits discriminatory treatment of interstate commerce, regardless of the form that discrimination takes. *West Lynn Creamery*, 512 U.S. at 192; *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). The doctrine of intergovernmental tax immunity, by contrast, prohibits only discriminatory *taxation*; it does not limit a State's ability to employ its spending power to set benefits for state retirees at whatever level the State may choose. The difference is significant because a discriminatory subsidy, at least when funded by a related facially non-discriminatory tax, poses the same danger of protectionism that the Commerce Clause addresses. An increase in the federally-taxable benefits of state workers, by contrast, eliminates the danger that the intergovernmental tax immunity doctrine addresses by redressing any artificial reduction of state costs at the expense of the federal treasury. See *Davis*, 489 U.S. at 815 n.4.

In any event, the limitations of the dormant Commerce Clause apply only when a State acts "in its distinctive governmental capacity," not when it acts "in the more general capacity of a market participant" or proprietor. *New Energy Co.* v. *Limbach*, 486 U.S. 269, 277 (1988); see *Reeves, Inc.* v. *Stake*, 447 U.S. 429, 438 & n.10, 446 (1980) (holding that the state-operator of a cement plant may favor in-state buyers over out-of-state buyers and explaining that the market-participant exception to the dormant Commerce Clause is supported by "[c]onsideration of [state] sovereignty"). Where, as here, a State provides employment benefits to its retired employees, it is indisputably acting in its proprietary capacity. Cf. *Clark* v. *United States*, 691

F.2d 837, 841-842 (7th Cir. 1982) (rejecting equal protection challenge to law mandating cost-of-living adjustments for federal but not state pensioners because the "United States, acting in its *proprietary* rather than its *governmental* capacity, has special responsibilities and obligations to its employees that it does not have to non-federal employees") (emphasis added).

II. There Is No Conflict Over The Question Presented

1. Contrary to petitioners' claim that "the courts are in conflict about whether increases in state employees' compensation * * * are unconstitutional" (Pet. 10), every state appellate court that has considered the issue has concluded, like the court below, that "[a] state is entitled to raise the level of taxable compensation of its employees if it so chooses." Pet. App. 5a. The decisions of the Montana and Oregon Supreme Courts—*Sheehy* v. *Public Employees Ret. Div.*, 864 P.2d 762 (Mont. 1993), and *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998)—that petitioners claim "directly conflict[]" (Pet. 14) with the court's decision below and with a second decision by the Oregon Supreme Court, see *Ragsdale* v. *Department of Revenue*, 895 P.2d 1348, 1354 (en banc), cert. denied, 516 U.S. 1011 (1995), do not announce any contrary rule of law or apply any meaningfully different legal test. The differing outcomes in those cases are attributable to the peculiar characteristics of the various state laws reviewed and not to any actual conflict among the decisions.

a. In *Ragsdale*, 895 P.2d at 1354, the Oregon Supreme Court recognized that "not only is there nothing express in *Davis* or in 4 U.S.C. Section 111 that would

regulate the level of compensation of state employees, it would be illogical to suggest that there is anything in the underlying principle of intergovernmental tax immunity that would invalidate a state compensation plan in aspects unrelated to the level of taxation." But, the court continued, "[a] tax rebate or tax benefit program only for state employees clearly would be impermissible." *Id.* at 1356. Applying these principles to the 1991 Oregon statute before it, the court concluded that the law was permissible "compensation of [the State's] employees," because "there [was] no mathematical correlation between taxes and the benefits created," and "every state retiree who qualifie[d] for [the] benefits (based on years of service) * * * receive[d] the benefits, regardless of the state retiree's residency." *Id.* at 1350-1351, 1356.

The Oregon Supreme Court applied the same standard a few years later in *Vogl* v. *Department of Revenue*, 960 P.2d 373 (1998), to determine whether a 1995 increase in retirement benefits to state employees was permissible. The court again observed that the State could legitimately provide retirees "a general increase in compensation to 'make up' for lost net income," *id.* at 380, but could not institute "a tax *rebate* that discriminates against federal retirees." *Id.* at 379. Unlike the 1991 statute at issue in *Ragsdale*, the 1995 statute contained the hallmarks of a tax rebate: the retirement benefits were calculated "using a formula that [wa]s more closely and obviously tied to the Oregon personal income tax rate"; it allowed a benefit only as to the portion of the retiree's income attributable to service rendered before "the effective date of the exemption repeal"; it provided that no retiree would "acquire a right, contractual or otherwise, to the increased benefits"; and it expressly provided that

the increased benefits were "full and final payment of damages for any claim arising out of the repeal of the previously existing exemption." *Id.* at 376-377. On these facts, the court concluded that the increased benefit was an impermissible "*rebate*." *Id.* at 380.

In *Sheehy*, 864 P.2d at 768, the Montana Supreme Court similarly did not dispute that a State may compensate retirees through "an actual and legitimate pension or retirement benefit," but held that Montana could not grant state retirees a discriminatory "partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law." The statute at issue in that case repealed a tax exemption on state retirement benefits while simultaneously increasing benefits to the subset of retirees living in Montana that were newly subject to the tax; these additional benefits, moreover, were paid directly out of the State's general revenues, not the retirement fund from which retirement benefits were traditionally paid. *Ibid.* In light of these peculiar characteristics, the court reasoned that the additional payment "is not an actual and legitimate pension or retirement benefit" but a "tax rebate denominated otherwise." *Ibid.*[2]

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[2] Petitioners also cite *Almeter* v. *Virginia Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589, at *2 (Va. Cir. Ct. Nov. 6, 2000), as contributing to a division among the lower courts. Pet. 15-16. That decision was issued by a state trial court, however, and thus cannot contribute to a conflict among "state court[s] of last resort" within the meaning of this Court's Rule 10. In any event, the *Almeter* court's reasoning is consistent with the decision below and the analysis in *Sheehy*, *Ragsdale*, and *Vogl*. As in those cases, the *Almeter* court held that a State can validly "pay extra money to state retirees" and concluded that a one-time lump-sum payment to all state retirees and an across-the-board increase in benefits to all state retirees constituted compensation, not a tax rebate. See 2000 WL 1687589, at *1-*2.

b. Although petitioners are correct that the "outcomes" in these cases differ (Pet. 10), these differences are attributable to factual dissimilarities among the statutes under review, not, as petitioners claim, to "deep[ ] confus[ion]" over the "showing that is required to demonstrate that increased compensation is in fact an unconstitutional tax rebate." *Ibid.* The courts themselves ascribe the varying outcomes to fundamental differences among the retirement benefits under review. See *Ragsdale*, 895 P.2d at 1355-1356 (distinguishing *Sheehy* on the ground that the Montana statute provided that "only retirees who are Montana *residents* will receive the benefit" and that "the retirement benefits at issue are funded solely by the Montana *general fund*," which was not true of the 1991 Oregon law); *Vogl*, 960 P.2d at 379-380 (distinguishing *Ragsdale* on the ground that the 1995 statute before the court in *Vogl* "differs from its predecessor in several significant ways").

The South Carolina Supreme Court correctly pointed out that Act 189 lacks characteristics that other courts have found to establish that other state statutes were effectively tax rebates. Accordingly, the South Carolina Supreme Court rejected petitioners' argument that Act 189 would be unconstitutional under *Sheehy* and *Vogl*. The court explained that "the Montana Supreme Court [in *Sheehy*] relied heavily on the fact the adjustment was provided only to state retirees who are Montana residents," but "Act 189 provides the increase to all state retirees, regardless of their domicile." Pet. App. 7a. Moreover, the statute under review in *Vogl* "explicitly stated that its purpose was to compensate for damages" and "the benefit increases under [it] were mathematically correlated to replace the lost state retirement income," neither of which was true of Act 189.

Ibid. Petitioners may disagree with the weight the South Carolina Supreme Court assigned to those distinctions, but that disagreement reflects nothing more than a fact-bound dispute that does not implicate a broad conflict over a question of law.

2. Petitioners also err in contending (Pet. 14-15) that the court below departed from the analytical path followed by other state courts by holding that compensation can "*never* be characterized as an unconstitutional tax rebate." The court did not adopt such a sweeping rule. It held only that the particular increase before it was "not, in effect, a 'tax rebate.'" Pet. App. 3a. Nor did the court hold, as petitioners claim (Pet. 3; Reply Br. 1, 9), that the State has an "unfettered," "absolute" Tenth Amendment right to determine state employee compensation. It held instead that the State was free "to establish the level of its employees' compensation *as long as the State does not discriminate in taxation based on the source of the income.*" Pet. App. 3a (emphasis added). Thus, like the Montana and Oregon courts, the court below recognized that a State may not perpetuate a discriminatory tax scheme merely by disguising a tax rebate as compensation. *Ibid.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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